

## Note 1 - Summary of Significant Accounting Policies

The accompanying financial statements of the state of Washington have been prepared in conformity with generally accepted accounting principles (GAAP). The Office of Financial Management (OFM) is the primary authority for the state's accounting and reporting requirements. OFM has adopted the pronouncements of the Governmental Accounting Standards Board (GASB), which is the accepted standard-setting body for establishing governmental accounting and financial reporting principles nationally. For government-wide and enterprise fund reporting, the state follows only those private-sector standards issued on or before November 30, 1989, unless those pronouncements conflict with or contradict the pronouncements of the GASB. The more significant of the state's accounting policies follow.

### A. Reporting Entity

In evaluating how to define the state of Washington, for financial reporting purposes, management has considered: all funds, organizations, institutions, agencies, departments, and offices that are legally part of the state (the primary government); organizations for which the state is financially accountable; and other organizations for which the nature and significance of their relationship with the state are such that exclusion would cause the state's financial statements to be misleading or incomplete.

Financial accountability is manifest when the primary government appoints a voting majority of an organization's governing body and is able to impose its will on that organization or there is a potential for the organization to provide specific financial benefits to or impose specific financial burdens on the primary government. The primary government may be financially accountable if an organization is fiscally dependent on the primary government regardless of whether the organization has a separately elected governing board, a governing board appointed by a higher level of government, or a jointly appointed board. An organization is fiscally dependent if it is unable to determine its budget without another government having the substantive authority to approve or modify that budget, to levy taxes or set rates or charges without substantive approval by another government, or to issue bonded debt without substantive approval by another government.

Based on these criteria, the following are included in the financial statements of the primary government:

**STATE AGENCIES** - Except as otherwise described herein, all state elected offices, departments, agencies, commissions, boards, committees, authorities, and councils (agencies) and all funds and account groups of the state are included in the primary government. Executives of these agencies are either elected, directly appointed by the Governor, appointed by a board which is appointed by the Governor, or appointed by a board which is in part appointed by the Governor.

Additionally, a small number of board positions are established by statute or independently elected. The state Legislature creates these agencies, assigns their programs, approves operational funding, and requires financial accountability. The Legislature also authorizes all bond issuances for capital construction projects for the benefit of state agencies. The legal liability for these bonds and the ownership of agency assets reside with the state.

**COLLEGES AND UNIVERSITIES** - The governing boards of the five state universities, the state college, and the 33 state community and technical colleges are appointed by the Governor. Each college's governing board appoints a president to function as chief administrator. The state Legislature approves budgets and budget amendments for the colleges' appropriated funds, which include the state's General Fund as well as certain capital projects funds. The state Treasurer issues general obligation debt for major campus construction projects. However, the colleges are authorized to issue revenue bonds for construction of facilities for certain revenue generating activities such as housing, dining, and parking. These revenue bonds are payable solely from and secured by fees and revenues derived from the operation of constructed facilities; the legal liability for the bonds and the ownership of the college assets reside with the state. Colleges do not have separate corporate powers and sue and are sued as part of the state with legal representation provided through the state Attorney General's Office. Since the colleges are legally part of the state, their financial operations, including their blended component units, are reported in the primary government financial statements using the fund structure prescribed by GASB, not discretely reported according to the fund structure of the American Institute of Certified Public Accountants college and university reporting model.

**RETIREMENT SYSTEMS** - The state of Washington, through the Department of Retirement Systems, administers seven retirement systems for public employees of the state and political subdivisions: the Public Employees' Retirement System, the Teachers' Retirement System, the School Employees' Retirement System, the Law Enforcement Officers' and Fire Fighters' Retirement System, the Washington State Patrol Retirement System, the Judicial Retirement System, and the Judges Retirement Fund. The director of the Department of Retirement Systems is appointed by the Governor.

There are two additional retirement systems administered outside of the Department of Retirement Systems. The Volunteer Fire Fighters' Relief and Pension Fund is administered through the Board for Volunteer Fire Fighters, which is appointed by the Governor. The Judicial Retirement Account is administered through the Administrator for the Courts under the direction of the Board for Judicial Administration.

The state Legislature establishes laws pertaining to the creation and administration of all public retirement systems. The participants of the public retirement systems together with the state provide funding for all costs of the systems based upon actuarial valuations. The state establishes benefit levels and approves the actuarial assumptions used in determining contribution levels.

All nine of the aforementioned retirement systems are included in the primary government's financial statements.

#### **BLENDED COMPONENT UNIT**

Blended component units are entities that are legally separate from the state but reported as if part of the state when they exist for the exclusive benefit of the state. The following is blended in the state's financial statements:

**TOBACCO SETTLEMENT AUTHORITY (TSA)** – The TSA was created by the Washington State Legislature in March 2002 as a public instrumentality separate and distinct from the state. It is governed by a five-member board appointed by the governor. It was created to issue bonds to securitize a portion of the state's future tobacco settlement revenue in order to generate funds for increased costs of health care, long-term care, and other programs of the state. In November 2002, the TSA issued \$517 million in bonds and transferred \$450 million to the state in exchange for 29.2 percent of the state's tobacco settlement revenue stream for the estimated 17-year period that the bonds remain outstanding.

#### **DISCRETE COMPONENT UNITS**

Discrete component units are entities which are legally separate from the state but which are financially accountable to the state. The following are discretely presented in the financial statements of the state in the component units column:

The WASHINGTON STATE HOUSING FINANCE COMMISSION, the WASHINGTON HIGHER EDUCATION FACILITIES AUTHORITY, the WASHINGTON HEALTH CARE FACILITIES AUTHORITY, and the WASHINGTON ECONOMIC DEVELOPMENT FINANCE AUTHORITY (financing authorities) were created by the Legislature in a way that specifically prevents them from causing the state to be liable or responsible for their acts and obligations, including, but not limited to, any obligation to pay principal and interest on financing authority bonds. The financing authorities cannot obligate the state, either legally or morally, and the state has not assumed any obligation of, or with respect to, the financing authorities.

The financing authorities are reported as discrete component units because state officials either serve on or appoint the members of the governing bodies of the authorities. The state also has the ability to influence the operations of the authorities through legislation.

Financial reports of these financing authorities may be obtained from each authority at the following addresses:

Washington Health Care Facilities Authority  
410 - 11th Avenue SE, Suite 201  
PO Box 40935  
Olympia, WA 98504-0935

Washington State Housing Finance Commission  
Washington Higher Education Facilities Authority  
Washington Economic Development Finance Authority  
1000 Second Avenue, Suite 2700  
Seattle, WA 98104-1046

The WASHINGTON STATE PUBLIC STADIUM AUTHORITY (PSA) was created by the Legislature to acquire, construct, own, and operate a stadium, exhibition center, and parking garage. The state has budget approval authority over a majority of PSA's funding sources. Further, conditioned upon certain events occurring, the state is authorized to issue and has issued general obligation bonds to participate in the funding of project construction costs. Under statute, the state's share of the total project cost is capped at \$300 million. Project costs in excess of \$300 million are the responsibility of the project's private partner, First & Goal, Inc. The bonds will be repaid through new state lottery games, a state sales tax credit, extension of the local hotel/motel tax, and parking and admissions taxes

at the new facility. Financial reports of the PSA may be obtained at the following address:

Washington State Public Stadium Authority  
401 Second Avenue South, Suite 520  
Seattle, WA 98104-0280

## **B. Government-wide and Fund Financial Statements**

### **Government-wide Financial Statements**

The state presents two basic government-wide financial statements: the Statement of Net Assets and the Statement of Activities. These government-wide financial statements report information on all non-fiduciary activities of the primary government and its component units. The financial information for the primary government is distinguished between governmental and business-type activities. Governmental activities generally are financed through taxes, intergovernmental revenues, and other non-exchange revenues. Business-type activities are financed in whole or in part by fees charged to external parties for goods and services.

**Statement of Net Assets** – The Statement of Net Assets presents the state’s non-fiduciary assets and liabilities. As a general rule, balances between governmental and business-type activities are eliminated.

Assets and liabilities are presented in a net assets format in order of liquidity. Net assets are classified into three categories:

- Invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation and reduced by outstanding balances of bonds, notes and other debt that are attributed to the acquisition, construction, or improvement of those assets.
- Restricted net assets results when constraints are placed on net asset use either by external parties or by law through constitutional provision or enabling legislation.
- Unrestricted net assets consist of net assets that do not meet the definition of the two preceding categories.

**Statement of Activities** - The Statement of Activities reports the extent to which each major state program is supported by general state revenues or is self-financed through fees and intergovernmental aid. For governmental activities, a major program is defined as a function. For business-type activities, a major program is an identifiable activity.

Program revenues offset the direct expenses of major programs. Direct expenses are those that are clearly identifiable within a specific function or activity. Program revenues are identified using the following criteria:

- Charges to customers for goods and services of the program. A customer is one who directly benefits from the goods or services or is otherwise directly affected by the program, such as a state citizen or taxpayer, or other governments or nongovernmental entities.
- Amounts received from outside entities that are restricted to one or more specific program. These amounts can be operating or capital in nature.
- Earnings on investments that are restricted to a specific program are also considered program revenues.

General revenues consist of taxes and other items not meeting the definition of program revenues.

Generally the effect of internal activities is eliminated. Exceptions to this rule include charges between the health insurance and workers’ compensation insurance programs and various other state programs and functions. Elimination of these charges would distort the direct costs and revenues reported for the various activities involved.

### **Fund Financial Statements**

The state uses 500 accounts that are combined into 54 rollup funds. The state presents separate financial statements for governmental funds, proprietary funds, and fiduciary funds. Major individual governmental funds and major individual proprietary funds are reported in separate columns in the fund financial statements, with nonmajor funds being combined into a single column regardless of fund type. Internal service and fiduciary funds are reported by fund type. Major funds include:

#### **Major Governmental Funds:**

- **General Fund** is the state’s primary operating fund. This fund is used to account for all financial resources and transactions not required to be accounted for in other funds.
- **Higher Education Special Revenue Fund** primarily accounts for grants and contracts received for research and other educational purposes. This fund also accounts for charges for services by state institutions of higher education.

- **Higher Education Endowment Fund** is used by the state to account for gifts and bequests that the donors have specified must remain intact. Each gift is governed by various restrictions on the investment and use of the funds.

#### Major Enterprise Funds:

- **Workers' Compensation Fund** is used to account for the workers' compensation program that provides medical, time-loss, and disability benefit payments to qualifying individuals sustaining work-related injuries.
- **Unemployment Compensation Fund** is used to account for the unemployment compensation program. It accounts for the deposit of funds requisitioned from the Federal Unemployment Trust Fund, to provide services to eligible participants within the state, and to pay unemployment benefits.

The state includes the following governmental and proprietary fund types within nonmajor funds:

#### Nonmajor Governmental Funds:

- **Special Revenue Funds** are used to account for a variety of state programs including public safety and health assistance programs; natural resource and wildlife protection and management programs; the state's transportation programs which include the operation of the state's ferry system and maintenance and preservation of non-interstate highway system; K-12 school construction; and construction and loan programs for local public works projects.
- **Debt Service Funds** are used by the state to account for the accumulation of resources for, and the payment of, principal and interest on the state's general obligation bonds.
- **Capital Projects Funds** are used to account for the acquisition, construction, and remodeling of public buildings including higher education facilities.
- **Common School Permanent Fund** accounts for the principal derived from the sale of timber. Interest earned is used for the benefit of common schools.

#### Nonmajor Proprietary Funds:

- **Enterprise Funds** are used to account for the state's business type operations including: the health insurance program; student housing and dining, parking and bookstore operations; the state lottery; state liquor stores; the guaranteed

tuition and college savings program; and the convention and trade center.

- **Internal Service Funds** are used to account for the provision of legal, motor pool, data processing, risk management, and other services by one department or agency to other departments or agencies of the state on a cost-reimbursement basis.

The state reports the following fiduciary funds:

- **Pension (and other employee benefit) Trust Funds** - are used to report resources that are required to be held in trust by the state for the members and beneficiaries of defined benefit pension plans, defined contribution pension plans, and other employee benefit plans.
- **Local Government Investment Pool (LGIP)** is used to report the external portion of LGIP, which is reported, by the state as the sponsoring government.
- **Private-Purpose Trust Funds** are used to report trust arrangements, other than pension and investment trusts, under which principal and income benefit individuals, private organizations, or other governments. Examples include administration of grants in aid for rural hospitals and unclaimed property.
- **Agency Funds** - are used to account for resources held by the state in a purely custodial capacity for other governments, private organizations or individuals.

#### Operating and Non-operating Revenues and Expenses

The state's proprietary funds make a distinction between operating and nonoperating revenues and expenses. Operating revenues and expenses generally result from providing goods and services directly related to the principal operations of the funds. For example, operating revenues for the state's workers' compensation and health insurance funds consist of premiums collected and investment earnings. Operating expenses consist of the claims paid to covered individuals, claims adjustment expenses, costs of commercial insurance coverage and administrative expenses. All revenues and expenses not meeting this definition are reported as nonoperating, including interest expense and investment gains and losses.

#### Application of Restricted/Unrestricted Resources

When both restricted and unrestricted resources are available for use, it is the state's policy to use restricted resources first, then unrestricted resources as they are needed.

### C. Measurement Focus and Basis of Accounting

For government-wide reporting purposes, the state uses the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of the related cash flows. Property taxes are recognized as revenue in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

For fund statement reporting purposes, the state uses the current financial resources measurement focus and modified accrual basis of accounting for governmental funds. With the current financial resources measurement focus, generally only current assets and current liabilities are included on the balance sheet. Operating statements for these funds present increases (i.e., revenues and other financing sources) and decreases (i.e., expenditures and other financing uses) in net current assets.

Under the modified accrual basis of accounting, revenues are recognized when susceptible to accrual (i.e., when they become both measurable and available). “Measurable” means the amount of the transaction can be reasonably estimated. “Available” means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. Primary revenues that are determined to be susceptible to accrual include sales taxes, business and occupation taxes, motor fuel taxes, federal grants-in-aid, and charges for services.

Revenues from property taxes are determined to be available if collected within 60 days. Revenue for timber cutting contracts is accrued when the timber is harvested. Revenues from licenses, permits, and fees are recognized when received in cash. Revenues related to expenditure driven grant agreements are recognized when the qualifying expenditures are made. All other accrued revenue sources are determined to be available if collectible within 12 months.

Property taxes are levied in December for the following calendar year. The first half-year collections are due by April 30, and the second half-year collections are due by October 31. Since the state is on a fiscal year ending June 30, the first half-year collections are recognized as revenue, if collected within 60 days of the fiscal year end. The second half-year collections are recognized as receivables offset by deferred revenue. The lien date on property taxes is January 1 of the tax levy year.

Under modified accrual accounting, expenditures are recognized when the related fund liability is incurred. Exceptions to the general modified accrual expenditure recognition criteria include unmatured interest on general

long-term obligations which is recognized when due, and certain compensated absences and claims and judgments which are recognized when the obligations are expected to be liquidated with expendable available financial resources.

The state reports deferred revenues on its governmental fund balance sheet. Deferred revenues arise when a potential revenue does not meet both the “measurable” and the “available” criteria for revenue recognition in the current period. Deferred revenues also arise when resources are received by the state before it has a legal claim to them, such as when grant monies are received prior to the incurrence of qualifying expenditures.

All proprietary and trust funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operations of these funds are included on the statement of net assets. Operating statements present increases (i.e., revenues) and decreases (i.e., expenses) in net assets. Net assets are presented as 1) invested in capital assets, net of related debt, 2) restricted and 3) unrestricted.

All proprietary and trust funds are reported using the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized when incurred.

### D. General Budgetary Policies and Procedures

The legal level of budgetary control is at the fund/account, agency, and appropriation level, with administrative controls established at lower levels of detail in certain instances. The accompanying budgetary schedules presented as Required Supplementary Information (RSI) are not presented at the legal level of budgetary control. This is due to the large number of appropriations within individual agencies that would make such a presentation in the accompanying financial schedules extremely cumbersome. Section 2400.121 of the GASB Codification of Governmental Accounting and Financial Reporting Standards provides for the preparation of a separate report in these extreme cases. For the state of Washington, a separate report has been prepared for the 2001-2003 Biennium to illustrate legal budgetary compliance. Appropriated budget versus actual expenditures, and estimated versus actual revenues and other financing sources (uses) for appropriated funds at agency and appropriation level are presented in Report CAF1054 for governmental funds. A copy of this report is available at the Office of Financial Management, 6639 Capitol Boulevard, PO Box 43113, Olympia, Washington 98504-3113. For additional budgetary information, please refer to the notes to RSI presented later in this report.

## E. Cash and Investments

Investments of surplus or pooled cash balances are reported on the accompanying Statements of Net Assets, Balance Sheets and Statements of Cash Flows as “Cash and Pooled Investments.” The Office of the State Treasurer invests state treasury cash surpluses where funds can be disbursed at any time without prior notice or penalty. As a result, the cash balances of funds with surplus pooled balances are not reduced for these investments. For reporting purposes, pooled cash is stated at fair value or amortized cost, which approximates fair value. For the purposes of the Statement of Cash Flows, the state considers cash and short-term, highly-liquid investments, that are both readily convertible to cash and are so near their maturity dates that they present insignificant risk of changes in value because of changes in interest rates, to be cash equivalents.

The method of accounting for noncurrent investments varies depending upon the fund classification. Investments in the state’s Local Government Investment Pool (LGIP), an external investment pool operated in a manner consistent with the SEC’s Rule 2a-7 of the Investment Company Act of 1940, are reported at amortized cost. The Office of the State Treasurer prepares a stand-alone LGIP financial report. A copy of the report is available from the Office of the State Treasurer, PO Box 40200, Olympia, Washington 98504-0200, phone number (360) 902-9000 or TTY (360) 902-8963.

All other noncurrent investments are reported at fair value. The fair value of investments is based on published market prices and quotations from major investment brokers at current exchange rates, as available. Privately held mortgages have been valued at cost which approximates fair market value. The fair value of real estate investments has been estimated based on independent appraisals. Venture capital and leveraged buy-out investments are determined by independent investment advisors based on analysis of the audited financial statements of the underlying partnerships. For information on derivative financial instruments utilized by the state, refer to Note 3.

## F. Receivables

Receivables in the state’s governmental funds consist primarily of tax and federal revenues. Receivables in all other funds have arisen in the ordinary course of business. Receivables are recorded when either the asset or revenue recognition criteria (refer to Note 1.C) have been met. All receivables are reported net of an allowance for accounts estimated to be uncollectible.

For government-wide reporting purposes, amounts recorded as interfund/interagency receivables and

payables are eliminated in the governmental and business-type activities columns on the Statement of Net Assets, except for the net residual balance that is reported as “internal balances.” Amounts recorded in governmental and business-type activities as due to or from fiduciary funds have been reported as due to or from other governments.

## G. Inventories

Consumable inventories, consisting of expendable materials and supplies held for consumption, are reported in the state’s financial statements if the annual balance on hand within an agency is estimated to be \$25,000 or more. Consumable inventories are generally valued at cost using the first-in, first-out method. Donated consumable inventories are recorded at fair market value. Food stamps on hand are recorded at face value.

Merchandise inventories are generally valued at cost using the first-in, first-out method. All merchandise inventories are considered reportable for financial statement purposes.

For governmental activities, inventories are recorded using the consumption method. For business-type activities, inventories are expensed when used or sold.

For governmental fund reporting, inventory balances are also recorded as a reservation of fund balance indicating that they do not constitute “available spendable resources” except for \$54 thousand in food stamps and \$4.7 million in federally donated consumable inventories, both of which are offset by deferred revenues because they do not constitute a fund resource until issued or consumed.

## H. Capital Assets

Except as noted below, it is the state’s policy to capitalize all land; all additions and improvements to the state highway system; infrastructure, other than the state highway system, with a cost of \$100,000 or greater; and all other capital assets with a unit cost of \$5,000 or greater.

Art collections, library reserve collections, and museum and historical collections, that are considered inexhaustible in that their value does not diminish over time, are not capitalized by the state if all of the following conditions are met:

- The collection is held for public exhibition, education or research in furtherance of public service, rather than financial gain.
- The collection is protected, kept unencumbered, cared for, and preserved.

- The collection is subject to policy requirements that the proceeds from sales of collection items be used to acquire other items for the collection.

Capital assets acquired by capital leases with a net present value or fair market value, whichever is less, of less than \$10,000 are not capitalized.

Purchased capital assets are valued at cost where historical records are available and at estimated historical cost where no historical records exist. Capital asset costs include the purchase price plus those costs necessary to place the asset in its intended location and condition for use. Normal maintenance and repair costs that do not materially add to the value or extend the life of the state's capital assets are not capitalized.

Donated capital assets are valued at their estimated fair market value on the date of donation, plus all appropriate ancillary costs. When the fair market value is not practically determinable due to lack of sufficient records, estimated cost is used. Where necessary, estimates of original cost and fair market value are derived by factoring price levels from the current period to the time of acquisition.

The value of assets constructed by agencies for their own use includes all direct construction costs and indirect costs that are related to the construction. In proprietary and trust fund type accounts, net interest costs (if material) incurred during the period of construction are capitalized.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets. Generally, estimated useful lives are as follows:

Buildings & building components	5-50 years
Furnishings, equipment & collections	5-50 years
Other improvements	3-50 years
Infrastructure	20-50 years

The cost and related accumulated depreciation of capital assets retired from service, or disposed of, are removed from the accounting records.

The state capitalizes the state highway system as a network but does not depreciate it since the system is being preserved approximately at or above a condition level established by the state. That condition level is documented and disclosed. Additionally, the highway system is managed using an asset management system that includes:

- Maintenance of an up-to-date inventory of system assets,
- Performance of condition assessments of the assets at least every three years with

summarization of the results using a measurement scale, and

- Annual estimation of the amount to maintain and preserve the assets at the condition level established and disclosed.

All state highway system expenditures that preserve the useful life of the system are expensed in the period incurred. Additions and improvements that increase the capacity or efficiency of the system are capitalized. This approach of reporting condition instead of depreciating the highway system is called the Modified Approach.

For government-wide financial reporting purposes, capital assets of the state are reported as assets in the applicable governmental or business-type activities column on the Statement of Net Assets. Depreciation expense related to capital assets is also reported in the Statement of Activities. Capital assets and the related depreciation expense are also reported in the proprietary fund financial statements.

For governmental fund reporting, capital assets are not reported on the balance sheet. Instead, capital acquisitions and construction are reflected as expenditures in the year acquired. No depreciation is reported.

## I. Compensated Absences

State employees accrue vested annual leave at a variable rate based on years of service. In general, accrued annual leave cannot exceed 30 days at the employee's anniversary date.

Employees accrue sick leave at the rate of one day per month without limitation on the amount that can be accumulated. Sick leave is not vested; i.e., the state does not pay employees for unused sick leave upon termination except upon employee death or retirement. At death or retirement, the state is liable for 25 percent of the employee's accumulated sick leave. In addition, the state has a "sick leave buyout option" in which each January, employees who accumulate sick leave in excess of 60 days may redeem sick leave earned but not taken during the previous year at the rate of one day's pay in exchange for each four days of sick leave.

It is the state's policy to liquidate unpaid compensated absence leave outstanding at June 30 with future resources rather than advance funding it with currently available expendable financial resources.

For government-wide reporting purposes, the state reports compensated absence obligations as liabilities in the applicable governmental or business-type activities columns on the Statement of Net Assets.

For fund statement reporting purposes, governmental funds recognize an expenditure for annual and sick leave when it is paid. Proprietary and trust funds recognize the expense and accrue a liability for annual leave and estimated sick leave buyout, including related payroll taxes and benefits as applicable, as the leave is earned.

## **J. Long-Term Liabilities**

In the government-wide and proprietary fund financial statements, long-term obligations of the state are reported as liabilities on the Statement of Net Assets. Bonds payable are reported net of applicable premium or discount. When material, bond premiums, discounts, and issue costs are deferred and amortized over the life of the bonds.

For governmental fund financial statements, the face amount of debt issued is reported as other financing sources. Premiums and discounts on debt issuance are also reported as other financing sources and uses respectively. Issue costs are reported as debt service expenditures.

## **K. Fund Equity**

In the fund financial statements, governmental funds report the difference between fund assets and fund liabilities as “Fund Balance.” Reserved fund balance represents that portion of fund balance that is: (1) not available for appropriation or expenditure, and/or (2) legally segregated for a specific future use. Unreserved, designated fund balance indicates tentative plans for future use of financial resources. Unreserved, undesignated fund balance represents the amount available for appropriation.

## **L. Insurance Activities**

### Workers’ Compensation

The state of Washington’s workers’ compensation program is established by Title 51 RCW. The statute requires all employers to insure payment of benefits for job related injuries and diseases through the Workers’ Compensation Fund or through self-insurance. Direct private insurance is not authorized, although self-insurers are permitted to reinsure up to 80 percent of their obligations through private insurers.

The Workers’ Compensation Fund, an enterprise fund, is used to account for the workers’ compensation program which provides time-loss, medical, disability, and pension payments to qualifying individuals sustaining work-related injuries. The main benefit plans of the workers’ compensation program are funded based on rates that will keep these plans solvent in accordance with recognized actuarial principles. The supplemental pension cost-of-living adjustments (COLA) granted for time-loss and disability payments, however, are funded on a pay-as-you-go basis. By statute, the state is only

allowed to collect enough revenue to fund the current COLA payments.

Premiums are based on individual employers’ reported payroll hours and insurance rates based on each employer’s risk classification(s) and past experience. In addition to its regular premium plans, the Workers’ Compensation Fund offers a retrospective premium rating plan under which premiums are adjusted annually for up to four years following the plan year based on individual employers’ loss experience. Initial adjustments to the standard premiums are paid to or collected from the employers approximately ten months after the end of each plan year.

The Workers’ Compensation Fund establishes claims liabilities based on estimates of the ultimate cost of claims (including future claims adjustment expenses) that have been reported but not settled, and of claims that have been incurred but not reported (IBNR). The length of time for which such costs must be estimated varies depending on the coverage involved. Because actual claims costs depend on such complex factors as inflation, changes in doctrines of legal liabilities, claims adjudication, and judgments, the process used in computing claims liabilities does not necessarily result in an exact amount. Claims liabilities are recomputed periodically using a variety of actuarial and statistical techniques to produce current estimates that reflect recent settlements, claim frequency, and other economic, legal, and social factors. A provision for inflation in the calculation of estimated future claim costs is implicit in the calculation because reliance is placed both on actual historical data that reflect past inflation and on other factors that are considered to be appropriate modifiers of past experience. Adjustments to claims liabilities are charged or credited to expense in the periods in which they are made.

### Risk Management

Washington State operates a risk management liability program pursuant to RCW 4.92.130. The state manages its tort claims as an insurance business activity rather than a general governmental activity. The state’s policy is generally not to purchase commercial insurance for the risk of losses to which it is exposed. Instead, the state management believes it is more economical to manage its risks internally and set aside assets for claims settlement in the Risk Management Fund, an internal service fund. A limited amount of commercial insurance is purchased for employee bonds and to limit the exposure to catastrophic losses. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years. Otherwise, the risk management liability program services all claims against the state for injuries and property damage to third parties. The majority of state funds and agencies participate in the risk management



liability program in proportion to the anticipated exposure to liability losses.

#### Health Insurance

The state of Washington administers and provides medical, dental, basic life, and long-term disability insurance coverage for eligible state employees. In addition, the state offers coverage to K-12 school districts, educational service districts, political subdivisions and employee organizations representing state civil service workers. The state establishes eligibility requirements and approves plan benefits of all participating health care organizations.

The state's share of the cost of coverage for state employees is based on a per capita amount determined annually by the Legislature and allocated to state agencies. The Health Care Authority, as administrator of the health care benefits program, collects this monthly "premium" from agencies for each active employee enrolled in the program. State employees self-pay for coverage beyond the state's contribution. Cost of coverage for non-state employees is paid by their respective employers. Most coverage is also available on a self-paid basis to eligible retirees, former employees, and employees who are temporarily not in pay status.

The state secures commercial insurance for certain coverage offered, but self-insures the risk of loss for the Uniform Medical Plan. Thirty-two percent of eligible subscribers were enrolled in the Uniform Medical Plan in Fiscal Year 2003. Claims are paid from premiums collected, and claims adjudication is contracted through a third-party administrator. Considerations in calculating liabilities include frequency of claims, administrative costs, industry inflation trends, advances in medical

technology, and other social and economic factors. Liabilities include an amount for claims incurred but not reported.

#### **M. Interfund/Interagency Activities**

The state engages in two major categories of interfund/interagency activity: reciprocal and nonreciprocal.

Reciprocal interfund/interagency activity is the internal counterpart to exchange and exchange-like transactions and includes both interfund loans and services provided and used. Nonreciprocal activity is nonexchange in nature and includes both transfers and reimbursements.

#### **N. Donor-restricted Endowments**

The state reports endowments in higher education endowment permanent accounts. These accounts are established outside of the state treasury for use by the higher education institutions. State law permits the governing boards of the institutions to appropriate for expenditure as much of the net appreciation, realized and unrealized, in the fair value of the assets of an endowment fund as is deemed prudent under the facts and circumstances prevailing at the time.

Generally, the institutions use a five percent spending rate policy for authorizing and spending investment income.

The net appreciation available for authorization for expenditure by the governing board totaled \$79.1 million and is reported in the nonexpendable portion of the reserve for permanent funds.

## Note 2 - Accounting and Reporting Changes

Fund equity at July 1, 2002, has been restated as follows (expressed in thousands):

	Fund equity at June 30, 2002, as previously reported	Fund Reclassification	Fund equity as restated, July 1, 2002
<b>Governmental Funds:</b>			
General	\$ 1,337,558	-	\$ 1,337,558
Higher Education Special Revenue	695,988	125,388	821,376
Higher Education Endowment	1,690,167	-	1,690,167
Nonmajor Governmental	3,408,277	17,174	3,425,451
<b>Proprietary Funds:</b>			
Enterprise Funds:			
Workers' Compensation	(6,064,485)	-	(6,064,485)
Unemployment Compensation	1,887,906	-	1,887,906
Nonmajor Enterprise Funds	1,002,108	-	1,002,108
Internal Service Funds:			
Nonmajor Internal Service Funds	(37,213)	-	(37,213)
<b>Fiduciary Funds:</b>			
Private Purpose Trust	202,413	(146,656)	55,757
Local Government Investment Pool	5,415,415	-	5,415,415
Pension and Other Employee Benefit Plans	41,358,692	-	41,358,692
<b>Component Units:</b>			
Public Stadium	458,109	-	458,109
Nonmajor Component Units	50,165	-	50,165

Fund Reclassification – The state implemented the provisions of GASB Statement No. 34 and No. 37 for Fiscal Year 2002 financial reporting purposes. During Fiscal Year 2003, it was discovered that certain accounts

were misclassified as private-purpose trusts. As a result, certain beginning fund balances were required to be restated to effect proper fund classification.

### Note 3 - Deposits and Investments

As of June 30, 2003, the carrying amount of Washington's cash and investments was \$68.7 billion. Total cash and investments at fiscal year-end amounted to \$68.9 billion, including cash from outstanding checks and warrants. Of this amount, cash on hand amounted to

\$50.7 million, deposits with financial institutions amounted to \$1.4 billion, and deposits in the federal Unemployment Trust Fund amounted to \$1.1 billion. The remaining \$66.4 billion represented the total carrying amount of investments.

Deposits by type, at June 30, 2003, are as follows (expressed in thousands):

Type of Deposit	Carrying Amount	Bank Balance	Insured/ Collateralized	Uninsured/ Uncollateralized
Demand deposits	\$ 142,781	\$ 277,218	\$ 276,745	\$ 473
Certificates of deposit	990,044	990,044	990,042	2
Cash with fiscal and escrow agents	173,418	109,622	81,757	27,865
<b>Total Deposits</b>	<b>\$ 1,306,243</b>	<b>\$ 1,376,884</b>	<b>\$ 1,348,544</b>	<b>\$ 28,340</b>

**DEPOSITS** - At fiscal year end, 97.7 percent of the state's deposits with financial institutions were either insured or collateralized, with the remainder uninsured/uncollateralized. The Federal Deposit Insurance Corporation (FDIC) covers the state's insured deposits. The Washington Public Deposit Protection Commission (PDPC) provides collateral protection. The PDPC (established under Chapter 39.58 of the Revised Code of Washington) constitutes a multiple financial institution collateral pool. Pledged securities under the PDPC collateral pool are held by the PDPC's agent in the name of the collateral pool.

**INVESTMENTS** - The State Investment Board, the Office of the State Treasurer, and the University of Washington manage approximately 97.4 percent of the state's investing activity. Management responsibilities and investment instruments as authorized by statute follow:

**STATE INVESTMENT BOARD (SIB)** - Statute designates SIB as having investment management responsibility for pension funds, the Workers' Compensation Fund, permanent funds (established at statehood), and other specific funds. Pursuant to statute (Chapter 43.33A RCW) and SIB policy, SIB is authorized and invests in the following: Treasury Bills; discount notes; repurchase agreements; reverse repurchase agreements; banker's acceptances; commercial paper; guaranteed investment contracts; U.S. government and agency (government sponsored corporations eligible for collateral purposes at the Federal Reserve) securities; nondollar bonds; investment grade corporate bonds; publicly traded mortgage-backed securities; privately placed mortgages; private placements of corporate debt; U.S. and foreign common stock; U.S. preferred stock; convertible securities; private equity including but not limited to investment corporations, partnerships, and limited liability

companies for venture capital, leveraged buy-outs, real estate, or other forms of private equity; asset backed securities; and derivative securities including futures, options, options on futures, forward contracts, and swap transactions.

The SIB is authorized to utilize various derivative financial instruments, including mortgage-backed securities, financial futures, forward contracts, interest rate and equity swaps, and options, to manage its exposure to fluctuations in interest and currency rates while increasing portfolio returns. Derivative transactions involve, to varying degrees, market and credit risk. SIB mitigates market risks arising from derivative transactions by requiring collateral in cash and investments to be maintained equal to the securities positions outstanding, and thereby prohibiting the use of leverage or speculation. Credit risks arising from derivative transactions are mitigated by selecting and monitoring creditworthy counterparties and collateral issuers.

Consistent with the SIB authority to invest in derivatives, international active equity managers may make limited investment in financial futures, forward contracts, or other derivative securities to manage exposure to currency rate risk and equitize excess cash holdings. No such derivative securities were held as of June 30, 2003. Domestic and foreign passive equity index fund managers may also utilize various derivative securities to manage exposure to risk and increase portfolio returns. Information on the extent of the use, and holdings of derivative securities by passive equity index fund managers is unavailable. At June 30, 2003, the only derivative securities held directly by SIB were collateralized mortgage obligations (CMO's) of \$3.3 billion.

State law and Board policy permit the SIB to participate in securities lending transactions. The Board has entered into agreements with State Street Corporation (SSC) to act as agent for the SIB in securities lending transactions. As SSC is the custodian bank for the SIB, it is a counterparty to securities lending transactions. Therefore, all cash collateral reinvested by SSC is reflected as Category 3 for custodial credit risk disclosure purposes.

Securities were loaned and collateralized by the SIB's agents with cash and U.S. government securities (exclusive of mortgage backed securities and letters of credit), and irrevocable letters of credit. When the loaned securities were denominated in United States dollars, or were securities whose primary trading market was located in the United States, or were sovereign debt that was issued by foreign governments, the collateral requirement was 102 percent of the market value of the securities loaned. When the loaned securities were not denominated in United States dollars or were securities whose primary trading market was not located in the United States, the collateral requirement was 105 percent of the market value of the loaned securities. The collateral held and market value of securities on loan at June 30, 2003 approximated \$3.1 and \$3.0 billion, respectively.

During Fiscal Year 2003, securities lending transactions could be terminated on demand by either the SIB or the borrower. The average term of overall loans was 45 days.

Cash collateral was invested by the SIBs agents in securities issued or guaranteed by the U.S. government, the SIBs short-term investment pool (average weighted maturity of 358 days), or term loans. Because the securities lending agreements were terminable at will, their duration did not generally match the duration of the investments made with the cash collateral. Noncash collateral could not be pledged or sold absent borrower default. There are no restrictions on the amount of securities that can be lent.

Securities were loaned with the agreement that they could be returned in the future for exchange of the collateral. SSC indemnified the SIB by agreeing to purchase replacement securities or return the cash collateral in the event a borrower failed to return the loaned securities or pay distributions thereon. SSC responsibilities included performing appropriate borrower and collateral investment credit analyses, demanding adequate types and levels of collateral, and complying with applicable federal regulations concerning securities lending.

During Fiscal Year 2003, there were no significant violations of legal or contractual provisions nor failures by any borrower to return loaned securities or to pay distributions thereon. Further, the SIB incurred no losses

during Fiscal Year 2003 resulting from a default by either the borrowers or the securities lending agents.

The SIB has entered into a number of agreements that commit the state, upon request, to make additional investment purchases up to a stated amount. As of June 30, 2003, the state had the following unfunded investment commitments (expressed in thousands):

Private equity partnerships	\$ 5,178,999
Real estate	888,552

OFFICE OF THE STATE TREASURER (OST) - The OST operates the state's Cash Management Account for investing cash in excess of daily requirements. Statute authorizes the OST to buy and sell the following types of instruments: U.S. government and agency securities, banker's acceptances, commercial paper, and certificates of deposit with qualified public depositories. Securities underlying repurchase and reverse repurchase agreements are limited to those stated above.

State statutes permit the OST to lend its securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. The OST, which has contracted with a lending agent to lend securities, earns a fee for this activity. The OST lending agent lends U.S. Government and U.S. Agency securities and receives collateral, which can be in the form of cash or other securities. The collateral, which must be valued at 102 percent of the fair value of the loaned securities, is priced daily and, if necessary, action is taken to maintain the collateralization level at 102 percent. The cash is invested by the lending agent in repurchase agreements or money market instruments, in accordance with investment guidelines approved by the OST. The securities held as collateral and the securities underlying the cash collateral are held by the custodian. The contract with the lending agent requires them to indemnify the OST if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or if the borrower fails to pay the OST for income distribution by the securities' issuers while the securities are on loan. The OST cannot pledge or sell collateral securities received unless the borrower defaults.

At June 30, 2003, securities on loan approximated \$383 million. All OST securities on loan were collateralized by cash and other securities and are classified in the schedule of custodial credit risk according to the category for the collateral received on the securities lent. On June 30, 2003, the average life of both the loans and the investment of cash received as collateral was one day.

The OST investment policy requires that any securities on loan be made available by the lending agent for next day liquidity at the option of the OST. During Fiscal Year 2003, the OST had no credit risk exposure to

borrowers because the amounts owed to the borrowers exceeded the amounts the borrowers owed the OST. There were no violations of legal or contractual provisions or any losses resulting from a default of a borrower or lending agent during the fiscal year.

Repurchase agreements are collateralized at 102 percent. The collateral is priced daily and held by the OST's custodian in the state's name. Collateral for mortgage-backed repurchase agreements with a maturity date longer than seven days will be priced at 105 percent of fair value, plus accrued interest. Collateralized Mortgage Obligations (CMO) used as collateral for repurchase agreements must pass the Federal Financial Institutions Examination Council (FFIEC) test, or not exceed a volatility rating of V-5 by Fitch Investor Services, or a similar rating of a nationally recognized rating agency.

State law also permits the OST to enter into reverse repurchase agreements, which are, by contract, sales of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. The fair value of the securities pledged as collateral by the OST underlying the reverse repurchase agreements normally exceeds the cash received, providing the dealers a margin against a decline in the fair value of the securities. If the dealers default on their obligations to resell these securities to the OST or to provide equal value in securities or cash, the OST would suffer an economic loss equal to the differences between the fair value plus accrued interest of the underlying securities and the agreement obligation, including accrued interest. The OST investment policy limits the amount of reverse repurchase agreements to 30 percent of the total portfolio. During the fiscal year, the OST did not enter into any reverse repurchase agreements and there were no obligations under reverse repurchase agreements outstanding at year-end.

UNIVERSITY OF WASHINGTON – The University's investment policies permit it to lend its securities to

broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. The University's custodian lends securities of the type on loan at year-end for collateral in the form of cash or other securities. U.S. securities are loaned versus collateral valued at 102 percent of the fair value of the securities plus any accrued interest. Non-U.S. securities are loaned versus collateral valued at 105 percent of the fair value of the securities plus any accrued interest. At year-end, the University has no credit risk exposure to borrowers because the amounts the University owes the borrowers exceed the amounts the borrowers owe the University. The contract with the custodian requires it to indemnify the University if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay the University for income distributions by the securities' issuers while the securities are on loan. Either the University or the borrower can terminate all securities loans on demand, although the average term of overall loans is ten days. Cash collateral is invested in a short-term investment pool. The relationship between the maturities of the investment pool and the University's loans is affected by the maturities of the securities loans made by other entities that use the custodian's pool, which the University cannot determine. Non-cash collateral cannot be sold unless the borrower defaults. Securities on loan at June 30, 2003, totaled \$453 million.

The University's investments include certain derivative instruments and structured notes that derive their value from a security, asset, or index. Such investments are governed by the University's Investment Policies and Guidelines, which effectively constrain their use by establishing (a) duration parameters which limit price sensitivity to interest rate fluctuations (market risk), (b) minimum quality ratings at both the security and portfolio level, and (c) a market index as a performance benchmark.

INVESTMENT ACTIVITY - The state's investments are categorized below per GASB Statement No. 3 to give an indication of the level of risk assumed at year-end. Category 1 includes investments that are insured, registered, or held by the state or its agent in the state's name. Category 2 includes uninsured and unregistered

investments that are held by the counterparties' trust departments or agents in the state's name. Category 3 includes uninsured and unregistered investments held by counterparties, or their trust departments or agents, but not in the state's name.

Investments at June 30, 2003, by investment type, are listed below (expressed in thousands):

Investment Type	Carrying Amount by GASB Categories			Carrying Amount	Fair Value
	1	2	3		
Corporate bonds	\$ 8,497,946	\$ 518	\$ -	\$ 8,498,464	\$ 8,498,464
Corporate stocks	2,414,857	610	-	2,415,467	2,415,467
U.S. government securities	1,961,217	-	-	1,961,217	1,961,205
Government securities	2,417,181	-	-	2,417,181	2,417,181
Collateralized mortgage obligations	3,335,845	-	-	3,335,845	3,335,844
Repurchase agreements	2,165,740	-	-	2,165,740	2,165,740
Asset backed securities	256,860	-	243,853	500,713	500,718
Commercial paper	2,547	-	-	2,547	2,547
Discount notes	4,196,343	-	-	4,196,343	4,196,343
Bankers' acceptances	5,055	-	-	5,055	5,055
Municipal bonds	19,908	-	-	19,908	19,930
Variable rate notes	-	-	2,417,517	2,417,517	2,417,517
Negotiable certificates of deposit	-	-	325,860	325,860	325,860
Other	2,460	-	-	2,460	2,460
	<u>\$ 25,275,959</u>	<u>\$ 1,128</u>	<u>\$ 2,987,230</u>	28,264,317	28,264,331
Mutual funds				4,413,054	4,413,054
Mortgages				1,560,565	1,560,565
Real estate				3,641,565	3,641,565
Private equity				5,902,436	5,902,436
Guaranteed investment contracts				544,107	544,107
Investments held by broker-dealers					
under securities lending programs:					
U.S. government securities				3,376,415	3,376,415
U.S. agency securities				465,823	465,823
Other investments				516,481	516,481
Commingled investment funds					
Foreign				3,402,501	3,402,501
Domestic				14,156,161	14,156,161
Other investment types				139,931	139,931
<b>Total Investments</b>				<u>\$ 66,383,356</u>	<u>\$ 66,383,370</u>

## Note 4 - Receivables and Deferred Revenues

### A. Governmental Funds

#### Taxes Receivable

Taxes receivable at June 30, 2003, consisted of the following (expressed in thousands):

Taxes Receivable	General	Higher Education Special Revenue	Higher Education Endowment	Nonmajor	Total
				Governmental Funds	
Property	\$ 788,866	\$ -	\$ -	\$ 728	\$ 789,594
Sales	1,228,327	-	-	22,659	1,250,986
Business and occupation	386,500	-	-	-	386,500
Estate	19,968	-	-	-	19,968
Fuel	-	-	-	967	967
Other	50,197	-	-	70,334	120,531
Subtotals	2,473,858	-	-	94,688	2,568,546
Less: Allowance for uncollectible receivables	94,614	-	-	125	94,739
<b>Total Taxes Receivable</b>	<b>\$ 2,379,244</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 94,563</b>	<b>\$ 2,473,807</b>

#### Other Receivables

Other receivables at June 30, 2003, consisted of the following (expressed in thousands):

Other Receivables	General	Higher Education Special Revenue	Higher Education Endowment	Nonmajor	Total
				Governmental Funds	
Public assistance	\$ 1,128,713	\$ -	\$ -	\$ -	\$ 1,128,713
Accounts receivable	13,922	87,615	783	56,482	158,802
Interest	-	8,027	8,272	4,195	20,494
Loans	14	121,228	-	222,423	343,665
Long-term contracts	5,377	-	9,316	114,866	129,559
Miscellaneous	9,637	69,595	8,049	12,514	99,795
Subtotals	1,157,663	286,465	26,420	410,480	1,881,028
Less: Allowance for uncollectible receivables	921,300	15,997	74	20,369	957,740
<b>Total Other Receivables</b>	<b>\$ 236,363</b>	<b>\$ 270,468</b>	<b>\$ 26,346</b>	<b>\$ 390,111</b>	<b>\$ 923,288</b>

Note: Public assistance receivables mainly represent amounts owed the state as a part of the Support Enforcement Program at the Department of Social and Health Services for the amounts due from persons required to pay support for individuals currently on state assistance, and have a low realization expectation. Accordingly, the receivable is offset by a large allowance for uncollectible receivables.

#### Deferred Revenues

Deferred revenues at June 30, 2003, consisted of the following (expressed in thousands):

Deferred Revenues	General Fund	Higher Education Special Revenue	Higher Education Endowment	Nonmajor	Total
				Governmental Funds	
Property taxes	\$ 768,263	\$ -	\$ -	\$ -	\$ 768,263
Other taxes	336,087	-	-	19	336,106
Timber sales	5,377	-	9,316	110,336	125,029
Charges for services	7,735	44,273	-	13,310	65,318
Food stamps	54	-	-	-	54
Donable goods	4,734	-	-	-	4,734
Miscellaneous	38,657	101,712	19	343,239	483,627
<b>Total Deferred Revenues</b>	<b>\$ 1,160,907</b>	<b>\$ 145,985</b>	<b>\$ 9,335</b>	<b>\$ 466,904</b>	<b>\$ 1,783,131</b>

## B. Proprietary Funds

### Taxes Receivable

Taxes receivable at June 30, 2003, consisted of \$4.1 million in liquor taxes reported in Nonmajor Enterprise Funds.

### Other Receivables

Other receivables at June 30, 2003, consisted of the following (expressed in thousands):

Other Receivables	Business-Type Activities			Total	Governmental
	Enterprise Funds				Activities
	Workers' Compensation	Unemployment Compensation	Nonmajor Enterprise Funds		Internal Service Funds
Accounts receivable	\$ 65,454	\$ -	\$ 197,625	\$ 263,079	\$ 5,467
Interest	94,891	-	2,345	97,236	332
Loans	-	-	4	4	-
Miscellaneous	489,064	486,048	7,054	982,166	31
Subtotals	649,409	486,048	207,028	1,342,485	5,830
Less: Allowance for uncollectible receivables	50,526	80,931	56,770	188,227	187
Total Other Receivables	\$ 598,883	\$ 405,117	\$ 150,258	\$ 1,154,258	\$ 5,643

### Deferred Revenues

Deferred revenues at June 30, 2003, consisted of the following (expressed in thousands):

	Business-Type Activities			Total	Governmental
	Enterprise Funds				Activities
	Workers' Compensation	Unemployment Compensation	Nonmajor Enterprise Funds		Internal Service Funds
Deferred Revenues					
Charges for services	\$ -	\$ -	\$ 5,370	\$ 5,370	\$ 686
Miscellaneous	14,824	-	25,319	40,143	34
Total Deferred Revenues	\$ 14,824	\$ -	\$ 30,689	\$ 45,513	\$ 720



## C. Fiduciary Funds

### Other Receivables

Other receivables at June 30, 2003, consisted of the following (expressed in thousands):

Other Receivables	Private-Purpose Trust	Local		Agency Funds
		Government Investment Pool	Pension and Other Employee Benefit Plans	
Accounts receivable	\$ -	\$ -	\$ 2,851	\$ 9,632
Interest	34	4,516	111,180	7,465
Loans	60	-	-	17
Miscellaneous	4,272	-	26,673	33,295
Subtotals	4,366	4,516	140,704	50,409
Less: Allowance for uncollectible receivables	45	-	129	340
<b>Total Other Receivables</b>	<b>\$ 4,321</b>	<b>\$ 4,516</b>	<b>\$ 140,575</b>	<b>\$ 50,069</b>

### Deferred Revenues

Deferred revenues recorded in Private-Purpose Trust funds at June 30, 2003, consisted of \$564 thousand related to charges for services and \$1.3 million related to other miscellaneous revenues.

## Note 5 - Interfund Balances and Transfers

### A. Interfund Balances

The following balances at June 30, 2003, represent due from and due to balances among all funds and state agencies (expressed in thousands):

Due To	Due From									Totals
	General	Higher Education Special Revenue	Higher Education Endowment	Nonmajor Governmental Funds	Workers' Compensation	Unemployment Compensation	Nonmajor Enterprise Funds	Internal Service Funds	Fiduciary Funds	
General	\$ 83,762	\$ 8,151	\$ -	\$ 95,824	\$ 47	\$ 1	\$ 986	\$ 460	\$ 14,181	\$ 203,412
Higher Educ. Special Revenue	28,836	19,088	-	9,442	169	-	43,923	4,653	23,886	129,997
Higher Education Endowment	-	-	-	-	-	-	-	-	194	194
Nonmajor Governmental Funds	142,611	5,269	2,223	78,178	159	-	11,877	1,382	17,795	259,494
Workers' Compensation	140	5	-	22	2,006	-	-	78	153	2,404
Unemployment Compensation	2,248	1,580	-	758	-	-	-	-	251	4,837
Nonmajor Enterprise Funds	9,811	2,736	-	1,146	-	-	42,072	238	5,359	61,362
Internal Service Funds	15,641	807	-	17,480	4,360	-	12,635	9,351	617	60,891
Fiduciary Funds	319,552	2,578	172,644	14,774	-	-	9,131	1,378	272,539	792,596
<b>Totals</b>	<b>\$ 602,601</b>	<b>\$ 40,214</b>	<b>\$ 174,867</b>	<b>\$ 217,624</b>	<b>\$ 6,741</b>	<b>\$ 1</b>	<b>\$ 120,624</b>	<b>\$ 17,540</b>	<b>\$ 334,975</b>	<b>\$ 1,515,187</b>

All interfund balances are expected to be paid within one year from the date of the financial statements. These balances resulted from the time lag between the dates

that (1) interfund goods and services were provided and when the payments occurred, and (2) interfund transfers were accrued and when the liquidations occurred.

### B. Interfund Transfers

Interfund transfers as reported in the financial statements reflect transfers between agencies and accounts reported within the same fund.

Net transfers between funds for the year ended June 30, 2003, consisted of the following (expressed in thousands):

Transferred From	Transferred To								Total
	General Fund	Higher Education Special Revenue	Higher Education Endowment	Nonmajor Governmental Funds	Workers' Compensation Fund	Nonmajor Enterprise Funds	Internal Service Funds	Private Purpose Funds	
General Fund	\$ 2	\$ 7,887	\$ -	\$ 708,249	\$ -	\$ -	\$ 9,592	\$ 2,232	\$ 727,962
Higher Educ. Special Revenue	-	64,120	50	136,776	-	19,672	2,375	17,939	240,932
Higher Education Endowment	-	56,564	11	29,510	-	7	-	2,515	88,607
Nonmajor Governmental Funds	508,638	16,495	1,456	547,419	-	14,802	-	5	1,088,815
Workers' Compensation Fund	-	-	-	5,490	329,126	-	-	-	334,616
Nonmajor Enterprise Funds	42,601	26,166	-	578,901	-	125,013	52	16,287	789,020
Internal Service Funds	-	2,792	-	2,892	-	20	421,911	-	427,615
Private Purpose Funds	36,749	2,203	171	-	-	16,254	2	6,966	62,345
<b>Total</b>	<b>\$ 587,990</b>	<b>\$ 176,227</b>	<b>\$ 1,688</b>	<b>\$ 2,009,237</b>	<b>\$ 329,126</b>	<b>\$ 175,768</b>	<b>\$ 433,932</b>	<b>\$ 45,944</b>	<b>\$ 3,759,912</b>

Transfers are used to 1) move revenues from the fund that statute requires to collect them to the fund that statute requires to expend them, 2) move receipts designated for debt service from the funds collecting the receipts to the debt service fund as debt service payments become due, 3) move unrestricted revenues collected in the General Fund to finance various programs accounted for in other funds in accordance with budgetary authorizations, 4) move profits from the Liquor

Revolving Account and the State Lottery Account as required by law, and 5) transfer amounts to and from the General Fund as required by law.

In the Fiscal Year ended June 30, 2003, the state recorded a transfer of \$450 million from the Tobacco Settlement Authority to the General Fund to provide funds for increased costs of health care, long-term care, and other state programs.

## Note 6 - Capital Assets

### A. Governmental Capital Assets

The following is a summary of governmental capital asset activity for the year ended June 30, 2003 (expressed in thousands):

Capital Assets	Balances July 1, 2002*	Additions	Deletions	Balances June 30, 2003
<b>Capital assets, not being depreciated:</b>				
Land	\$ 1,088,525	72,171	(27,635)	\$ 1,133,061
Highway System Infrastructure**	11,099,869	630,786	-	11,730,655
Construction in Progress	1,142,984	346,037	(325,653)	1,163,368
Art Collections, Library Reserves, and Museum and Historical Collections	74,570	66,352	(32,950)	107,972
Total capital assets, not being depreciated	13,405,948			14,135,056
<b>Capital assets, being depreciated:</b>				
Buildings	5,583,445	687,778	(216,092)	6,055,131
Accumulated depreciation	(1,866,806)	(162,755)	9,912	(2,019,649)
Net buildings	3,716,639			4,035,482
Furnishings, equipment, and collections	2,799,713	301,136	(124,033)	2,976,816
Accumulated depreciation	(1,549,763)	(168,398)	28,230	(1,689,931)
Net furnishings, equipment and collections	1,249,950			1,286,885
Other improvements and miscellaneous	664,604	108,362	(36,562)	736,404
Accumulated depreciation	(247,223)	(53,633)	24,731	(276,125)
Net other improvements and miscellaneous	417,381			460,279
Infrastructure (other)**	244,137	146,716	(107,809)	283,044
Accumulated depreciation	(73,160)	(28,756)	10,847	(91,069)
Net infrastructure (other)	170,977			191,975
Total capital assets, being depreciated, net	5,554,947			5,974,621
<b>Governmental activities capital assets, net</b>	<b>\$ 18,960,895</b>			<b>\$ 20,109,677</b>

\*Beginning balances have been restated to reflect fund type reclassifications.

\*\*The state first reported infrastructure under the new requirements of the Governmental Accounting Standards Board Statement Number 34 in Fiscal Year 2002. The state accounts for the State Highway System and Emergency Airfields using the modified approach and reports them as non-depreciable Highway System Infrastructure. The state's short rail line is depreciated and is reported as depreciable Infrastructure (other). Under the modified approach, rather than recording depreciation, asset condition is reported. The rating scales for pavements, bridges, and airfields are further explained in Required Supplementary Information.

## B. Business-type Capital Assets

The following is a summary of business-type capital asset activity for the year ended June 30, 2003, (expressed in thousands):

<b>Capital Assets</b>	<b>Balances July 1, 2002</b>	<b>Additions</b>	<b>Deletions</b>	<b>Balances June 30, 2003</b>
<b>Capital assets, not being depreciated:</b>				
Land	\$ 24,219	59,339	-	\$ 83,558
Art Collections and Library Reserves	35	-	-	35
Construction in Progress	300,708	199,249	(261,833)	238,124
Total capital assets, not being depreciated	324,962			321,717
<b>Capital assets, being depreciated:</b>				
Buildings	1,031,391	282,352	(96,644)	1,217,099
Accumulated depreciation	(369,577)	(19,643)	39	(389,181)
Net buildings	661,814			827,918
Furnishings, equipment, and collections	285,560	32,922	(31,304)	287,178
Accumulated depreciation	(200,715)	(21,860)	23,895	(198,680)
Net furnishings, equipment, and collections	84,845			88,498
Other Improvements and miscellaneous	36,661	2,158	(5,246)	33,573
Accumulated depreciation	(11,172)	(1,847)	894	(12,125)
Net other improvements and miscellaneous	25,489			21,448
Infrastructure (other)	24,220	4,352	-	28,572
Accumulated depreciation	(6,628)	(1,440)	-	(8,068)
Net infrastructure (other)	17,592			20,504
Total capital assets, being depreciated, net	789,740			958,368
<b>Business-type activities capital assets, net</b>	<b>\$ 1,114,702</b>			<b>\$ 1,280,085</b>

### C. Depreciation

Depreciation expense was charged to functions of the primary government as follows (in thousands):

	Amount
Governmental Activities:	
General Government	\$ 44,686
Education - Elementary and Secondary (K-12)	1,719
Education - Higher Education	250,462
Human Services	33,553
Adult Corrections	23,548
Natural Resources and Recreation	31,211
Transportation	73,360
Total Depreciation Expense - Governmental Activities	<u>\$ 458,539 *</u>
Business-Type Activities:	
Workers' Compensation	\$ 442
Unemployment Compensation	-
Health Insurance Programs	191
Higher Education Student Services	36,335
Other	7,822
Total Depreciation Expense - Business-Type Activities	<u>\$ 44,790</u>

\*Includes \$58,730 million internal service fund depreciation that was allocated to functions as a part of the net internal service fund activity.

## D. Construction in Progress

Major construction commitments of the state at June 30, 2003, are as follows (expressed in thousands):

Agency/Project Commitments	Construction In Progress June 30, 2003	Remaining Project Commitments
Department of General Administration:		
Various projects	\$ 128,300	\$ 259,970
Liquor Control Board:		
Distribution Center	30,367	155
Washington State Patrol:		
Seattle and Vancouver crime laboratories	940	21,365
Military Department:		
Readiness centers and other projects	24,063	14,437
Department of Social and Health Services:		
State hospital and juvenile rehabilitation renovations, and other projects	73,443	33,340
Department of Veterans Affairs:		
240 Bed Skilled Nursing Center and other projects	4,015	44,001
Department of Corrections:		
Correctional centers construction, improvements, and other projects	221,112	353,139
Eastern Washington State Historical Society		
Museum addition	23,109	2,000
Department of Transportation:		
State Highway System, maintenance facilities, ferry vessels, and terminals	173,672	736,868
Department of Fish and Wildlife:		
Hatchery renovations, site improvements, and other projects	3,671	8,167
Higher Education Facilities:		
University of Washington	443,833	297,674
Washington State University	47,294	133,418
Eastern Washington University	5,438	23,731
Central Washington University	42,857	13,696
The Evergreen State College	25,459	18,178
Western Washington University	64,772	33,280
Community and Technical Colleges	85,142	187,879
Other Agencies Miscellaneous Projects	4,004	10,189
<b>Total Construction in Progress</b>	<b>\$ 1,401,491</b>	<b>\$ 2,191,487</b>

## Note 7 – Long-Term Liabilities

### A. Bonds Payable

Bonds payable at June 30, 2003, are reported by the state of Washington within Governmental Activities and Business-Type Activities, as applicable.

The State Constitution and enabling statutes authorize the incurrence of state general obligation debt, to which the state's full faith, credit, and taxing power are pledged, either by the State Legislature or by a body designated by statute (presently the State Finance Committee). Legislative authorization arises from an affirmative vote of 60 percent of both legislative houses without voter consent, or from an affirmative vote of more than 50 percent of both legislative houses and a majority of the voters voting thereon. The State Finance Committee debt authorization does not require voter approval; however, it is limited to providing for: (1) temporary deficiencies in the state treasury (must be discharged within 12 months of the date of incurrence); (2) appropriations already made by the legislature; or (3) refunding of outstanding obligations of the state.

### Legal Debt Limitation

The State Constitution and current statutes generally limit debt authorized in the preceding procedures. The limitations prohibit the issuance of new debt if it would cause the maximum annual debt service, on all thereafter-outstanding general obligation debt, to exceed a specified percentage of the arithmetic mean of general state revenues for the preceding three fiscal years. These limitations are on the incurrence of new debt, not on the amount of debt service that may be paid by the state in future years.

As certified by the State Treasurer, the maximum debt authorization subject to limitation for Fiscal Year 2003 was \$6.5 billion, under the then current constitutional and statutory limitation. This computation excludes specific bond issues and types, which are not secured by general state revenues. Based on the debt limitation calculation, the debt service requirements as of June 30, 2003, did not exceed the authorized debt service limitation.

<b>Computation of Legal Debt Limitation (expressed in millions)<sup>1</sup></b>	
Three year mean, general state revenues	\$ 8,886
Legal Debt Limitation:	
Debt service limitation (7 percent of above)	\$ 622
Less: Projected maximum annual debt service of outstanding bonds	560
Uncommitted Portion of Debt Service Limitation	<u>\$ 62</u>
Remaining State general obligation debt capacity	\$ 846
Plus: Debt outstanding subject to limitation	5,622
Maximum Debt Authorization Subject to Limitation	<u>\$ 6,468</u>

<sup>1</sup> Source: Office of the State Treasurer – Certification of the Debt Limitation of the State of Washington for Fiscal Year 2003.

### Authorized but unissued

The state had a total of \$3,548 million in bonds authorized but unissued as of June 30, 2003, for the purpose of public building and schools construction and renovation, higher education purposes, and highways construction and improvement.

### Interest rates

Interest rates on fixed rate general obligation bonds ranged from 2.0 to 9.0 percent. Variable rate demand obligations (VRDO) of \$185.2 million as of June 30, 2003, are remarketed on a weekly basis. Interest rates on revenue bonds range from 3.0 to 9.0 percent.

### DEBT SERVICE REQUIREMENTS TO MATURITY

**General obligation bonds** have been authorized and issued primarily to provide funds for acquisition and

construction of capital facilities for public and common schools, higher education, public and mental health, corrections, conservation, and construction and improvements of highways, roads, and bridges. The state has also issued bonds for assistance to municipalities for construction of water and sewage treatment facilities and corrections facilities. In addition, bonds are authorized and issued to provide for the refunding of general obligation bonds outstanding. Outstanding general obligations bonds are presented in the Washington State Treasurer's Annual Report for 2003. A copy of the report is available from the Office of the State Treasurer, PO Box 40200, Olympia, Washington, 98504-0200, phone number (360) 902-9000 or TTY (360) 902-8963.

Total debt service requirements to maturity for general obligation bonds, as of June 30, 2003, are as follows (expressed in thousands):

General Obligation Bonds	Governmental Activities		Business-Type Activities		Totals	
	Principal	Interest	Principal	Interest	Principal	Interest
<b>By Fiscal Year:</b>						
2004	\$ 380,235	\$ 425,385	\$ 16,964	\$ 7,374	\$ 397,199	\$ 432,759
2005	391,248	408,816	16,841	6,443	408,089	415,259
2006	394,279	386,374	17,836	5,498	412,115	391,872
2007	407,073	371,150	19,027	4,510	426,100	375,660
2008	413,744	348,768	20,529	3,395	434,273	352,163
2009-2013	1,936,823	1,460,373	43,473	20,973	1,980,296	1,481,346
2014-2018	2,091,884	1,037,827	28,614	33,932	2,120,498	1,071,759
2019-2023	1,597,389	568,563	9,114	23,411	1,606,503	591,974
2024-2028	748,330	184,277	-	-	748,330	184,277
2029-2033	15,562	48,289	-	-	15,562	48,289
<b>Total Debt Service Requirements</b>	<b>\$ 8,376,567</b>	<b>\$ 5,239,822</b>	<b>\$ 172,398</b>	<b>\$ 105,536</b>	<b>\$ 8,548,965</b>	<b>\$ 5,345,358</b>

**Revenue Bonds** are authorized under current state statutes, which empower certain state agencies to issue bonds that are not supported, or not intended to be supported, by the full faith and credit of the state. These bonds pledge income derived from acquired or constructed assets for retirement of the debt and payment of the related interest.

The State's Colleges and Universities issue revenue bonds for the purposes of housing, dining, parking, and student facilities construction. Additionally, the Tobacco Settlement Authority (TSA), a blended component unit of the state, also issued revenue bonds secured by the TSA's right to receive 29.2 percent of the state's tobacco settlement revenue stream.

Total debt service requirements for revenue bonds to maturity as of June 30, 2003, are as follows (expressed in thousands):

Revenue Bonds	Business-Type Activities	
	Principal	Interest
<b>By Fiscal Year:</b>		
2004	\$ 9,668	\$ 49,844
2005	11,202	49,481
2006	10,663	49,011
2007	11,100	48,520
2008	22,098	48,034
2009-2013	127,869	222,817
2014-2018	153,407	182,323
2019-2023	164,521	135,586
2024-2028	189,277	83,586
2029-2033	148,847	22,352
<b>Total Debt Service Requirements</b>	<b>\$ 848,652</b>	<b>\$ 891,554</b>



## DEBT REFUNDINGS

When advantageous and permitted by statute and bond covenants, the State Finance Committee authorizes the refunding of outstanding bonds. When the state refunds outstanding bonds, the net proceeds of each refunding issue are used to purchase U.S. government securities that are placed in irrevocable trusts with escrow agents to provide for all future debt service payments on the refunded bonds. As a result, the refunded bonds are considered defeased and the liability has been removed from the government-wide statement of net assets.

## CURRENT YEAR DEFEASANCES

### Governmental Activities:

On October 2, 2002, the state issued \$605.9 million of Various Purpose General Obligation Refunding Bonds (Series R-2003A) with an average interest rate of 4.72 percent to refund \$597.4 million of Various Purpose General Obligation Bonds from several different series with an average interest rate of 5.76 percent. The refunding resulted in a \$72 million gross debt service savings over the next nineteen years and an economic gain of \$50.7 million.

On December 4, 2002, the state issued \$70.3 million in Motor Vehicle Fuel Tax General Obligation Refunding Bonds (Series R-2003B) with an average interest rate of 4.92 percent to refund \$68.4 million of Motor Vehicle Fuel Tax General Obligation bonds from several series with an average interest rate of 5.90 percent. The refunding resulted in a \$7 million gross debt service savings over the next seventeen years and an economic gain of \$4.7 million.

On May 27, 2003, the state issued \$77 million of Various Purpose General Obligation Refunding Bonds (Series R-2003C) with an average interest rate of 3.82 percent to refund \$75.5 million of Various Purpose General Obligation Bonds from several series with an average interest rate of 5.77 percent. The refunding resulted in a \$6.9 million gross debt service savings over the next ten years and an economic gain of \$6.5 million.

On June 4, 2003, the state issued \$25.7 million of Refunding Certificates of Participation (Series RE-

2003B) with an average interest rate of 4.5 percent to refund the remaining \$27.8 million of the 1991 Department of Ecology State Office Building Project, with an average interest rate of 5.0 percent. The refunding resulted in a \$5 million gross debt service savings over the next thirteen years and an economic gain of \$3.3 million.

### Business-Type Activities:

On August 6, 2002, Eastern Washington University issued \$4.5 million in Housing and Dining System Revenue and Refunding Bonds (Series 2002), with an average interest rate of 3.39 percent, to refund \$4.3 million in outstanding Housing and Dining System Revenue Bonds with an average interest rate of 6.20 percent. The refunding resulted in \$604,048 gross debt service savings over the next ten years and an economic gain of \$716,511.

On May 8, 2003, Western Washington University issued \$15.1 million of Revenue and Refunding Bonds (Series 2003), with an average interest rate of 3.52 percent, to refund \$3 million in outstanding Revenue Bonds (1991 and 1992 issues) with an average interest rate of 6.25 and 5.95 percent respectively, and to issue \$12 million of new bonds to fund housing renovations. The refunding of the bonds resulted in a \$390,000 gross debt service savings over the next 20 years and an economic loss of \$166,988.

## PRIOR YEAR DEFEASANCES

In prior years, the state defeased certain general obligation and other bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the prior bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the state's financial statements.

### General Obligation Bond Debt:

On June 30, 2003, \$48.5 million of general obligation bonded debt outstanding is considered defeased.

### Revenue Bond Debt:

On June 30, 2003, \$77.2 million of proprietary revenue bonded debt outstanding is considered defeased.

## B. Certificates of Participation

Current state law authorizes the state to enter into long-term financing contracts for the acquisition of real or personal property and for the issuance of certificates of participation in the contracts. These certificates of participation do not fall under the general obligation debt

limitations and are generally payable only from annual appropriations by the Legislature. Other specific provisions could also affect the state's obligation under certain agreements. The certificates of participation are recorded for financial reporting purposes if the possibility of the state not meeting the terms of the agreements is considered remote.

Total debt service requirements for certificates of participation to maturity as of June 30, 2003, are as follows (expressed in thousands):

Certificates of Participation	Governmental Activities		Business-Type Activities		Totals	
	Principal	Interest	Principal	Interest	Principal	Interest
<b>By Fiscal Year:</b>						
2004	\$ 29,637	\$ 16,651	\$ 23,792	\$ 14,760	\$ 53,429	\$ 31,411
2005	19,389	11,574	15,908	10,581	35,297	22,155
2006	17,084	10,761	14,247	9,906	31,331	20,667
2007	15,727	10,051	13,576	9,303	29,303	19,354
2008	14,807	9,375	13,071	8,713	27,878	18,088
2009-2013	88,435	35,309	81,230	33,046	169,665	68,355
2014-2019	75,843	12,706	71,319	11,955	147,162	24,661
2019-2023	15,226	1,749	14,328	1,646	29,554	3,395
2024-2028	124	6	121	5	245	11
<b>Total Debt Service Requirements</b>	<b>\$ 276,272</b>	<b>\$ 108,182</b>	<b>\$ 247,592</b>	<b>\$ 99,915</b>	<b>\$ 523,864</b>	<b>\$ 208,097</b>

Note: An additional \$5 million certificates of participation, related to fiduciary activities, remain outstanding as of June 30, 2003.

### C. Claims and Judgments

Claims and judgments are materially related to three activities: workers' compensation, risk management, and health insurance. Workers' compensation and health insurance are business-type activities, and risk management is a governmental activity. A description of the risks to which the state is exposed by these activities,

and the ways in which the state handles the risks, is presented in Note 1L.

#### Workers' Compensation

Changes in the balances of workers' compensation claims liabilities during Fiscal Years 2002 and 2003 were as follows (expressed in thousands):

	Balances Beginning of Fiscal Year	Incurred Claims and Changes in Estimates	Claim Payments	Balances End of Fiscal Year
<b>Workers' Compensation Fund</b>				
FY 2002	\$ 14,243,113	2,045,466	(1,405,480)	\$ 14,883,099
FY 2003	\$ 14,883,099	2,489,547	(1,508,794)	\$ 15,863,852

At June 30, 2003, \$33.7 billion of unpaid claims and claim adjustment expenses are presented at their net present value of \$15.9 billion. These claims are discounted at assumed interest rates of 4.0 percent (time loss and medical) to 6.5 percent (pensions) and are net of third party recoveries.

basis, and the Workers' Compensation actuaries have indicated that future premium payments will be sufficient to pay these claims as they come due. The remaining claims liabilities of \$8.0 billion are fully funded by long-term investments, net of obligations under securities lending agreements.

The claims and claim adjustment liabilities of \$15.9 billion, as of June 30, 2003, include \$7.9 billion for supplemental pension cost of living adjustments (COLAs) that by statute are not to be fully funded. These COLA payments are funded on a pay-as-you-go

#### Risk Management

Changes in the balances of risk management claims liabilities during Fiscal Years 2002 and 2003 were as follows (expressed in thousands):

	Balances Beginning of Fiscal Year	Incurred Claims and Changes in Estimates	Claim Payments	Tort Defense Payments	Balances End of Fiscal Year
<b>Risk Management Fund</b>					
FY 2002	\$ 268,737	189,909	(33,638)	(22,538)	\$ 402,470
FY 2003	\$ 402,470	153,250	(40,082)	(16,724)	\$ 498,914

Risk Management reports claims and judgment liabilities when it becomes probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an actuarially determined amount for claims that have been incurred but not reported. It also includes an actuarial estimate of loss adjustment expenses for tort defense. Because actual claims liabilities depend on such complex factors as inflation, changes in legal doctrines, and damage awards, it should be recognized that future loss emergence will likely deviate, perhaps materially, from the actuarial estimates. Claims liabilities are re-evaluated annually to take into consideration recently settled claims, the frequency of claims, and other economic or social factors.

The state is a defendant in a significant number of lawsuits pertaining to property and casualty matters. As of June 30, 2003, outstanding and actuarially determined claims against the state and its public authorities were \$498.9 million for which the state has recorded a liability. The state is restricted by law from accumulating funds in the Self Insurance Liability Program in excess of 50 percent of total outstanding and actuarially determined claims. At June 30, 2003, the Risk Management Fund held \$14.3 million in cash and pooled investments designated for payment of these claims under the state's Self Insurance Liability Program.

### Health Insurance

Changes in the balances of Health Insurance claim liabilities during Fiscal Years 2002 and 2003 were as follows (expressed in thousands):

<b>Health Insurance Fund</b>	<b>Balances Beginning of Fiscal Year</b>	<b>Incurred Claims and Changes in Estimates</b>	<b>Claim Payments</b>	<b>Balances End of Fiscal Year</b>
FY 2002	\$ 43,147	297,836	(294,057)	\$ 46,926
FY 2003	\$ 46,926	332,047	(331,039)	\$ 47,934

The Health Insurance Fund establishes a liability when it becomes probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an actuarially determined amount for claims that have been incurred but not reported. Because actual claims liabilities depend on various complex factors, the process used in computing claims liabilities does not always result in an exact amount. Claims liabilities are re-evaluated periodically to take into consideration recently settled claims, the frequency of claims, and other economic and social factors.

At June 30, 2003, health insurance claims liabilities totaling \$47.9 million are fully funded with cash and investments, net of obligations under securities lending agreements.

### **D. Leases**

The state leases land, office facilities, office and computer equipment, and other assets under a variety of agreements. Although lease terms vary, most leases are subject to appropriation from the state Legislature to continue the obligation. If the possibility of receiving no funding from the Legislature is remote, leases are considered noncancelable for financial reporting purposes. Leases that represent acquisitions are classified as capital leases, and the related assets and liabilities are recorded in the financial records at the inception of the lease. Other leases are classified as operating leases with the lease payments recorded as expenditures or expenses during the life of the lease. Certain operating leases are renewable for specified periods. In most cases, management expects that the leases will be renewed or replaced by other leases.

Leased land, buildings and equipment under capital leases as of June 30, 2003, include the following (expressed in thousands):

	<b>Governmental Activities</b>	<b>Business-Type Activities</b>
Land (non-depreciable)	\$ 3,368	\$ -
Buildings	50,697	\$ 6,182
Equipment	23,933	946
Less: Accumulated Depreciation	(21,825)	(771)
<b>Totals</b>	<b>\$ 56,173</b>	<b>\$ 6,357</b>

The following schedule presents future minimum payments for capital and operating leases as of June 30, 2003, (expressed in thousands):

Capital and Operating Leases	Capital Leases		Operating Leases	
	Governmental Activities	Business-Type Activities	Governmental Activities	Business-Type Activities
<b>By Fiscal Year:</b>				
2004	\$ 6,794	\$ 710	\$ 93,056	\$ 22,215
2005	6,716	690	80,938	21,062
2006	6,460	649	68,493	19,239
2007	5,170	625	53,578	18,529
2008	4,334	615	38,679	17,234
2009-2013	7,479	2,261	159,318	5,578
2014-2018	574	2,175	68,084	-
2019-2023	348	1,663	46,312	-
2024-2028	-	-	46,848	-
2029-2033	-	-	45,372	-
Total Future Minimum Payments	37,875	9,388	700,678	103,857
Less: Executory costs and interest costs	6,331	3,506	-	-
Net Present Value of future minimum lease payments	\$ 31,544	\$ 5,882	\$ 700,678	\$ 103,857

The total operating lease rental expense for Fiscal Year 2003 was \$129.7 million.

## E. Long-Term Liability Activity

Long-term liability activity for the Fiscal Year 2003 (expressed in thousands) was as follows:

	Beginning Balance July 1, 2002	Additions	Reductions	Ending Balance June 30, 2003	Amounts Due Within One Year
<b>Governmental Activities:</b>					
Long-term Debt:					
Bonds Payable -					
General obligation (GO) bonds	\$7,750,915	\$1,295,645	\$1,134,335	\$7,912,225	\$366,825
GO - zero coupon bonds (principal)	246,254	233,002	14,914	464,342	13,410
Subtotal	7,997,169	1,528,647	1,149,249	8,376,567	380,235
GO - zero coupon bonds (accrued interest)	152,105	17,948	17,450	152,603	-
Total bonds payable	8,149,274	1,546,595	1,166,699	8,529,170	380,235
Other liabilities -					
Certificates of participation	248,657	32,127	4,512	276,272	29,637
Claims and judgments	471,383	547,623	425,452	593,554	122,324
Leases	35,055	7,040	10,551	31,544	6,794
Compensated absences	392,041	286,654	280,159	398,536	35,441
Unfunded pension obligations	44,700	5,200	-	49,900	-
Other	150,642	458,983	419,046	190,579	145,166
Total other liabilities	1,342,478	1,337,627	1,139,720	1,540,385	339,362
<b>Total</b>	<b>\$9,491,752</b>	<b>\$2,884,222</b>	<b>\$2,306,419</b>	<b>\$10,069,555</b>	<b>\$719,597</b>

For Governmental Activities, payments on the certificates of participation are being repaid directly from various governmental funds. The compensated absences liability will be liquidated approximately 53 percent by the General Fund, 24 percent by the Higher Education Special Revenue Funds, and the balance by various other

governmental funds. The claims and judgments liability will be liquidated primarily through the risk management fund, an internal service fund. Leases, installment contract obligations, and other liabilities will be repaid from various other governmental funds.

State of Washington

<b>Business-Type Activities</b>	Beginning Balance July 1, 2002	Additions	Reductions	Ending Balance June 30, 2003	Amounts Due Within One Year
Long-term Debt:					
Bonds Payable -					
General obligation (GO) bonds	\$ 157,845	\$ 261	\$ 14,967	\$ 143,139	\$ 16,964
GO - zero coupon bonds (principal)	29,259	-	-	29,259	-
Limited revenue bonds	-	517,905	-	517,905	-
Revenue bonds	327,512	19,281	16,046	330,747	9,668
Less: Deferred amounts on refunding	(3,328)	(331)	56	(3,603)	-
Subtotal	511,288	537,116	30,957	1,017,447	26,632
GO - zero coupon bonds (accreted interest)	15,048	2,795	-	17,843	-
Less: Deferred amounts for issuance discounts	(1,771)	(14,203)	522	(15,452)	-
Subtotal	13,277	(11,408)	522	2,391	-
Total bonds payable	524,565	525,708	30,435	1,019,838	26,632
Other liabilities -					
Certificates of participation	235,905	135,084	123,397	247,592	23,792
Less: Deferred amounts for issuance discounts	(2,624)	1	571	(2,052)	-
Claims and judgments	14,933,093	2,824,973	1,842,730	15,915,336	1,533,558
Lottery prize annuities payable	542,496	134,093	147,435	529,154	70,046
Tuition benefits payable	207,900	154,509	12,409	350,000	15,300
Leases	1,758	4,532	408	5,882	710
Compensated absences	35,777	23,754	22,348	37,183	19,740
Other	24,475	51,520	39,244	36,749	35,998
Total other liabilities	15,978,780	3,328,466	2,187,400	17,119,844	1,699,144
<b>Total</b>	<b>\$16,503,345</b>	<b>\$3,854,174</b>	<b>\$2,217,835</b>	<b>\$18,139,682</b>	<b>\$1,725,776</b>

The limited revenue bonds were issued by the Tobacco Settlement Authority (TSA), which is a blended component unit of the state. The bonds are obligations of the TSA and are secured solely by the TSA's right to receive 29.2 percent of the state's tobacco settlement

revenues, restricted investments of the TSA, and undistributed TSA bond proceeds. These bonds do not constitute either a legal or moral obligation of the state, nor does the state pledge its full faith, credit or taxing power for payment of these bonds.

## Note 8 - No Commitment Debt

The Washington State Housing Finance Commission, Washington Higher Education Facilities Authority, Washington Health Care Facilities Authority, and Washington Economic Development Finance Authority (financing authorities) were created by the state Legislature. For financial reporting purposes, they are discretely presented as component units. These financing authorities issue bonds for the purpose of making loans to qualified borrowers for capital acquisitions, construction, and related improvements.

These bonds do not constitute either a legal or moral obligation of the state or these financing authorities, nor does the state or these financing authorities pledge their faith and credit for the payment of such bonds. Debt service on the bonds is payable solely from payments made by the borrowers pursuant to loan agreements. Due to their no commitment nature, the bonds issued by these financing authorities are excluded from the state's financial statements.

The table below presents the latest available balances for the "No Commitment" debt of the state's financing authorities (expressed in thousands):

No Commitment Debt	Principal Balance
Washington State Housing Finance Commission	\$ 2,060,740
Washington Higher Education Facilities Authority	332,317
Washington Health Care Facilities Authority	2,700,000
Washington Economic Development Finance Authority	292,621
<b>Total No Commitment Debt</b>	<b>\$ 5,385,678</b>

## Note 9 – Fund Balances Reserved or Designated for Other Specific Purposes

The nature and purposes of fund balances reserves and designations for other specific purposes as of June 30, 2003, are listed below (expressed in thousands):

Fund Balances	General	Higher Education Special Revenue	Higher Education Endowment	Nonmajor Governmental Funds	Totals
<b>Reserved for Other Specific Purposes:</b>					
Long-term student loans	\$ -	\$ 92,035	\$ -	\$ -	\$ 92,035
Investments with trustees	599	-	-	451	1,050
Long-term receivables	32,780	641	-	1,069,175	1,102,596
Long-term investments	-	121,191	-	29,286	150,477
Emergency reserve	-	-	-	57,631	57,631
Petty cash	611	3,693	-	824	5,128
<b>Total Reserved for Other Specific Purposes</b>	<b>\$ 33,990</b>	<b>\$ 217,560</b>	<b>\$ -</b>	<b>\$ 1,157,367</b>	<b>\$ 1,408,917</b>
<b>Unreserved, Designated for Other Specific Purposes:</b>					
Higher education	\$ -	\$ 155,679	\$ -	\$ -	\$ 155,679
Miscellaneous	-	-	-	168	168
<b>Total Unreserved, Designated for Other Specific Purposes</b>	<b>\$ -</b>	<b>\$ 155,679</b>	<b>\$ -</b>	<b>\$ 168</b>	<b>\$ 155,847</b>



## Note 10 - Deficit Net Assets

At June 30, 2003, there were three proprietary funds with deficit net assets.

The Workers' Compensation Fund, an enterprise fund, had deficit net assets of \$6.2 billion at June 30, 2003. The fund is used to account for the workers' compensation program, which provides time-loss, medical, disability, and pension payments to qualifying individuals sustaining work-related injuries. The main

benefit plans of the workers' compensation program are funded based on rates that will keep these plans solvent in accordance with recognized actuarial principles. The supplemental pension cost-of-living adjustments (COLA) granted for time-loss and disability payments, however, are funded on a pay-as-you-go basis. By statute, the state is only allowed to collect enough revenue to fund the current COLA payments.

The following schedule details the changes in total net assets for the Workers' Compensation Fund during the fiscal year ended June 30, 2003, (expressed in thousands):

	Net Assets (Deficit)
<b>Workers' Compensation Fund</b>	
<b>Balances, July 1, 2002</b>	\$ (6,064,485)
Fiscal Year 2003 activity	(181,528)
<b>Balances, June 30, 2003</b>	<b>\$ (6,246,013)</b>

The Risk Management Fund, an internal service fund, had deficit net assets of \$ 484.3 million at June 30, 2003. The Risk Management Fund is used to account for the claims, torts, judgments generally arising from automobile and general government operations, and loss adjustment expenses for tort defense. These costs are supported by premium assessments to state agencies that are designed to cover current and future claim losses. Outstanding and incurred but not reported claims are actuarially determined and accrued, resulting in the deficit net assets.

The Self Insurance Liability Program initiated in 1990 is intended to provide funds for the payment of all claims and loss adjustment expenses for tort defense.

The state is restricted by law from accumulating funds in the Self Insurance Liability Program in excess of 50 percent of total outstanding and actuarially determined claims.

The following schedule details the changes in net assets for the Risk Management Fund during the fiscal year ended June 30, 2003, (expressed in thousands):

	Net Assets (Deficit)
<b>Risk Management Fund</b>	
<b>Balance, July 1, 2002</b>	\$ (395,216)
Fiscal Year 2003 activity	(89,097)
<b>Balance, June 30, 2003</b>	<b>\$ (484,313)</b>

The Other Activities Fund, an enterprise fund, had deficit net assets of \$ 415.0 million at June 30, 2003. The Other Activities Fund is used to account for various enterprise activities of the state including the blended enterprise component unit, the Tobacco Settlement Authority (TSA). In Fiscal Year 2003, the TSA issued \$517 million in bonds and transferred \$450 million to the state

in exchange for 29.2 percent of the state's tobacco settlement revenue stream. This revenue stream represents a contingent asset and, in accordance with accounting standards, cannot be recognized until the contingency no longer exists. As a result, the TSA reflects deficit net assets as of June 30, 2003, of \$441 million.

The following schedule details the changes in net assets for the Other Activities Fund during the fiscal year ended June 30, 2003, (expressed in thousands):

Other Activities Fund	Net Assets (Deficit)
Balances, July 1, 2002	\$ 13,091
Fiscal Year 2003 activity	(428,072)
<b>Balances, June 30, 2003</b>	<b>\$ (414,981)</b>

## Note 11 - Retirement Plans

### A. General

The state of Washington, through the Department of Retirement Systems, the Board for Volunteer Fire Fighters, and the Administrator for the Courts, administers 12 defined benefit retirement plans, three combination defined benefit/defined contribution retirement plans, and one defined contribution retirement plan covering eligible employees of the state and local governments. Pension plans administered by the state are accounted for using the accrual basis of accounting. Under the accrual basis of accounting, employee and employer contributions are recognized in the period in which employee services are performed; investment gains and losses are recognized as incurred; and benefits and refunds are recognized when due and payable in accordance with the terms of the applicable plan.

#### DEPARTMENT OF RETIREMENT SYSTEMS

As established in chapter 41.50 of the Revised Code of Washington (RCW), the Department of Retirement Systems (DRS) administers seven retirement systems comprising 11 defined benefit pension plans and three combination defined benefit/defined contribution plans as follows:

- Public Employees' Retirement System (PERS)
  - Plan 1 - defined benefit
  - Plan 2 - defined benefit
  - Plan 3 - defined benefit/defined contribution
- Teachers' Retirement System (TRS)
  - Plan 1 - defined benefit
  - Plan 2 - defined benefit
  - Plan 3 - defined benefit/defined contribution
- School Employees' Retirement System (SERS)
  - Plan 2 - defined benefit
  - Plan 3 - defined benefit/defined contribution
- Law Enforcement Officers' and Fire Fighters' Retirement System (LEOFF)
  - Plan 1 - defined benefit
  - Plan 2 - defined benefit
- Washington State Patrol Retirement System (WSPRS)
  - Plan 1 - defined benefit
  - Plan 2 - defined benefit
- Judicial Retirement System (JRS)
  - Defined benefit plan
- Judges' Retirement Fund (Judges)
  - Defined benefit plan

Although some assets of the plans are commingled for investment purposes, each plan's assets may be used only for the payment of benefits to the members of that plan in accordance with the terms of the plan.

Administration of the PERS, TRS, SERS, and LEOFF systems and plans was funded by an employer rate of .22 percent of employee salaries. Administration of the WSPRS, JRS, and Judges plans is funded by means of legislative appropriations.

The Department of Retirement Systems prepares a stand-alone financial report. Copies of the report that include financial statements and required supplemental information may be obtained by writing to Washington State Department of Retirement Systems, PO Box 48380, Olympia, Washington 98504-8380.

#### BOARD FOR VOLUNTEER FIRE FIGHTERS

As established in chapter 41.24 RCW, the Washington Board for Volunteer Fire Fighters' administers the Volunteer Fire Fighters' Relief and Pension Fund (VFFRPF), a defined benefit plan. Administration of VFFRPF is funded through legislative appropriation.

#### ADMINISTRATOR FOR THE COURTS

As established in chapter 2.14 RCW, the Administrator for the Courts administers the Judicial Retirement Account (JRA), a defined contribution plan. Administration of JRA is funded through member fees.

In addition to the retirement plans administered by the state of Washington, eligible higher education state employees may participate in the Teachers' Insurance and Annuity Association/College Retirement Equity Fund (TIAA/CREF) which is a privately administered defined contribution plan.

Plan descriptions, funding policies, and a table of employer contributions required and paid for defined benefit plans follow at Notes 11.B through D respectively. For information related to defined contribution plans, refer to Note 11.I. Details on plan net assets and changes in plan net assets of pension plans administered by the state are presented at Note 11.J.

Membership of each state administered plan consisted of the following at September 30, 2002, the date of the latest actuarial valuation for all plans except for VFFRPF which had an actuarial valuation performed on December 31, 2002.

Defined Benefit Plans Administered by the State	Retirees and Beneficiaries Receiving Benefits	Terminated Plan Members Entitled to but not yet Receiving Benefits	Active Plan Members Vested	Active Plan Members Nonvested	Total
PERS 1	54,006	3,280	20,167	1,570	79,023
PERS 2	9,741	15,674	68,372	48,567	142,354
PERS 3	9	198	10,455	5,054	15,716
TRS 1	33,148	1,822	12,096	360	47,426
TRS 2	823	2,487	7,005	804	11,119
TRS 3	283	2,151	17,154	28,644	48,232
SERS 2	437	1,397	13,535	9,335	24,704
SERS 3	185	1,148	12,025	14,896	28,254
LEOFF 1	7,987	22	1,146	1	9,156
LEOFF 2	244	376	10,076	3,935	14,631
WSPRS 1	718	95	780	255	1,848
JRS	131	3	24	-	158
Judges	18	-	1	-	19
JRA	3	10	184	-	197
VFFRPF	2,854	4,389	4,944	6,959	19,146

Following is a summary of government employers participating in state administered retirement plans as of June 30, 2003.

Plan	State Agencies	Public Schools	Counties/ Municipalities	Other Political Subdivisions
PERS 1	156	253	209	252
PERS 2	168	-	269	440
PERS 3	141	-	159	204
TRS 1	86	284	-	-
TRS 2	38	270	-	-
TRS 3	44	291	-	-
SERS 2	9	290	-	-
SERS 3	10	288	-	-
LEOFF 1	-	-	104	25
LEOFF 2	7	-	224	128
WSPRS 1	1	-	-	-
WSPRS 2	1	-	-	-
JRS	3	-	-	-
Judges	-	-	-	-
JRA	3	-	-	-
VFFRPF	-	-	-	520

## B. Plan Description

### Public Employees' Retirement System (PERS)

PERS is a cost-sharing multiple-employer retirement system comprised of three separate plans for membership purposes: Plans 1 and 2 are defined benefit plans and Plan 3 is a combination defined benefit/defined contribution plan. PERS participants who joined the system by September 30, 1977, are Plan 1 members. Those who joined on or after October 1, 1977, and by either, February 28, 2002, for state and higher education employees, or August 31, 2002, for local government employees, are Plan 2 members unless they exercise an option to transfer their membership to Plan 3. PERS participants joining the system on or after March 1, 2002, for state and higher education employees, or September 1, 2002, for local government employees have the irrevocable option of choosing membership in either PERS Plan 2 or PERS Plan 3. The option must be exercised within 90 days of employment. An employee is reported in Plan 2 until a choice is made. Employees who fail to choose within 90 days default to PERS Plan 3.

PERS defined benefit retirement benefits are financed from a combination of investment earnings and employer and employee contributions. Employee contributions to the PERS Plan 1 and 2 defined benefit plans accrue interest at a rate specified by DRS. During Fiscal Year 2003, the DRS-established rate on employee contributions was 5.5 percent compounded quarterly. Employees in PERS Plan 1 and 2 can elect to withdraw total employee contributions and interest thereon upon separation from PERS-covered employment. PERS Plan 3 defined contribution benefits are financed from

employee contributions and investment earnings. Employees in PERS Plan 3 can elect to withdraw total employee contributions adjusted by earnings and losses from the investment of those contributions upon separation from PERS-covered employment.

The Legislature established PERS in 1947. Membership in the system includes: elected officials; state employees; employees of the Supreme, Appeals, and Superior Courts (other than judges currently in a judicial retirement system); employees of legislative committees; community and technical colleges, college and university employees not in national higher education retirement programs such as Teachers' Insurance and Annuity Association/College Retirement Equity Fund (TIAA/CREF); judges of district and municipal courts; and employees of local governments. TIAA/CREF is not administered by DRS. Approximately 52 percent of PERS salaries are accounted for by state employment. PERS retirement benefit provisions are established in state statute and may be amended only by the state Legislature.

PERS Plan 1 retirement benefits are vested after an employee completes five years of eligible service. Plan 1 members are eligible for retirement after 30 years of service, or at the age of 60 with five years of service, or at the age of 55 with 25 years of service. The annual benefit is 2 percent of the average final compensation (AFC) per year of service (AFC is based on the greatest compensation during any 24 eligible consecutive compensation months), capped at 60 percent.

PERS Plan 2 retirement benefits are vested after an employee completes five years of eligible service. Plan

2 members may retire at the age of 65 with five years of service, or at the age of 55 with 20 years of service, with an allowance of 2 percent of the AFC per year of service. (AFC is based on the greatest compensation during any eligible consecutive 60-month period.) Plan 2 retirements prior to the age of 65 receive reduced benefits. If retirement is at age 55 or older with at least 30 years of service, a 3 percent per year reduction applies; otherwise an actuarial reduction will apply. There is no cap on years of service credit; and a cost-of-living allowance is granted (indexed to the Seattle Consumer Price Index), capped at 3 percent annually.

PERS Plan 3 has a dual benefit structure. Employer contributions finance a defined benefit component, and member contributions finance a defined contribution component. The defined benefit portion provides a benefit calculated at 1 percent of the AFC per year of service. (AFC is based on the greatest compensation during any eligible consecutive 60-month period.) Plan 3 members become eligible for retirement if they have: at least ten years of service; or five years including 12 months that were earned after age 54; or five service credit years earned in PERS Plan 2 prior to June 1, 2003. Plan 3 retirements prior to the age of 65 receive reduced benefits. If retirement is at age 55 or older with at least 30 years of service, a 3 percent per year reduction applies; otherwise an actuarial reduction will apply. There is no cap on years of service credit; and Plan 3 provides the same cost-of-living allowance as Plan 2. Refer to section I of this note for a description of the defined contribution component of PERS Plan 3.

PERS Plan 1 provides duty and non-duty disability benefits. Duty disability retirement benefits for disablement prior to the age of 60 consist of a temporary life annuity payable to the age of 60. The allowance amount is \$350 a month, or two-thirds of the monthly AFC, whichever is less. The benefit is reduced by any worker's compensation benefit and is payable as long as the member remains disabled or until the member attains the age of 60. A member with five years of membership service is eligible for non-duty disability retirement. Prior to the age of 55, the allowance amount is 2 percent of the AFC for each year of service reduced by 2 percent for each year that the member's age is less than 55. The total benefit is limited to 60 percent of the AFC.

PERS Plan 2 and Plan 3 provide disability benefits. There is no minimum amount of service credit required for eligibility. The Plan 2 allowance amount is 2 percent of the AFC for each year of service. For Plan 3 the allowance amount is 1 percent of the AFC for each year of service. Benefits are actuarially reduced for each year that the member's age is less than 65, and to reflect the choice of a survivor option.

Legislation passed in the 2003 session provides a \$150,000 death benefit to the estate of an employee of schools, higher education and state agencies who dies in the line of service, if found eligible by the Department of Labor and Industries. There were no other material changes in PERS benefit provisions for the fiscal year ended June 30, 2003.

PERS pension benefit provisions have been established by chapter 41.40 RCW.

PERS is comprised of three separate plans for reporting purposes: Plan 1, Plan 2/3, and Plan 3. Plan 1 accounts for the defined benefits of Plan 1 members. Plan 2/3 accounts for the defined benefits of Plan 2 members and the defined benefit portion of benefits for Plan 3 members. Plan 3 accounts for the defined contribution portion of benefits for Plan 3 members. Although members can only be a member of either Plan 2 or Plan 3, the defined benefit portions of Plan 2 and Plan 3 are accounted for in the same pension trust fund. All assets of this Plan 2/3 defined benefit plan may legally be used to pay the defined benefits of any of the Plan 2 or Plan 3 members or beneficiaries, as defined by the terms of the plan. Therefore, Plan 2/3 is considered to be a single plan for reporting purposes.

#### **Teachers' Retirement System (TRS)**

TRS is a cost-sharing multiple-employer retirement system comprised of three separate plans for membership purposes: Plans 1 and 2 are defined benefit plans and Plan 3 is a combination defined benefit/defined contribution plan. TRS participants who joined the system by September 30, 1977, are Plan 1 members. Those who joined on or after October 1, 1977, and by June 30, 1996, are Plan 2 members unless they exercised an option to transfer their membership to Plan 3. TRS participants joining the system on or after July 1, 1996, and those who exercised their transfer option, are members of TRS Plan 3.

TRS defined benefit retirement benefits are financed from a combination of investment earnings and employer and employee contributions. Employee contributions to the TRS Plan 1 and 2 defined benefit plans accrue interest at a rate specified by DRS. During Fiscal Year 2003, the DRS-established rate on employee contributions was 5.5 percent compounded quarterly. Employees in TRS Plan 1 and 2 can elect to withdraw total employee contributions and interest thereon upon separation from TRS-covered employment. TRS Plan 3 defined contribution benefits are financed from employee contributions and investment earnings. Employees in TRS Plan 3 can elect to withdraw total employee contributions adjusted by earnings and losses from the investment of those contributions upon separation from TRS-covered employment.

TRS was legislatively established in 1938. Eligibility for membership requires service as a certificated employee in grades K-12 in the public schools. TRS is comprised principally of non-state employees. TRS retirement benefit provisions are established in state statute and may be amended only by the State Legislature.

TRS Plan 1 retirement benefits are vested after an employee completes five years of eligible service. Plan 1 members are eligible for retirement after 30 years of service, or at the age of 60 with five years of service, or at the age of 55 with 25 years of service. The annual pension is 2 percent of the average final compensation (AFC) per year of service (AFC is based on the greatest compensation during the highest of any consecutive two compensation contract years), capped at 60 percent.

TRS Plan 2 retirement benefits are vested after an employee completes five years of eligible service. Plan 2 members may retire at the age of 65 with five years of service, or at the age of 55 with 20 years of service, with an allowance of 2 percent of the AFC per year of service. (AFC is based on the greatest compensation during any eligible consecutive 60-month period.) Plan 2 retirements prior to the age of 65 receive reduced benefits. If retirement is at age 55 or older with at least 30 years of service, a 3 percent per year reduction applies; otherwise an actuarial reduction will apply. There is no cap on years of service credit; and a cost-of-living allowance is granted (indexed to the Seattle Consumer Price Index), capped at 3 percent annually.

TRS Plan 3 has a dual benefit structure. Employer contributions finance a defined benefit component, and member contributions finance a defined contribution component. The defined benefit portion provides a benefit calculated at 1 percent of the AFC per year of service. (AFC is based on the greatest compensation during any eligible consecutive 60-month period.) Plan 3 members become eligible for retirement if they have: at least ten years of service; or five years including 12 months that were earned after age 54; or five service credit years earned in TRS Plan 2 by July 1, 1996, and transferred to Plan 3. Plan 3 retirements prior to the age of 65 receive reduced benefits. If retirement is at age 55 or older with at least 30 years of service, a 3 percent per year reduction applies; otherwise an actuarial reduction will apply. There is no cap on years of service credit; and Plan 3 provides the same cost-of-living allowance as Plan 2. Refer to section I of this note for a description of the defined contribution component of TRS Plan 3.

TRS Plan 1 provides death and duty disability benefits. TRS Plan 1 members receive the following additional lump sum death benefits: retired members-\$400 (if at least 10 years of membership service), active members-\$600. Members on temporary disability receive a temporary life annuity of \$180 per month payable up to

two years. After five years of service, members on a disability retirement receive an allowance based on their salary and service to date of disability. Members enrolled in TRS prior to April 25, 1973, may elect a benefit based on the formula in effect at that time.

TRS Plan 2 and Plan 3 provide disability benefits. There is no minimum amount of service credit required for eligibility. The Plan 2 allowance amount is 2 percent of the AFC for each year of service. For Plan 3, the allowance amount is 1 percent of the AFC for each year of service. Benefits are actuarially reduced for each year that the member's age is less than 65, and to reflect the choice of a survivor option.

Legislation passed in the 2003 session provides a \$150,000 death benefit to the estate of an employee of schools, higher education and state agencies who dies in the line of service, if found eligible by the Department of Labor and Industries. There were no other material changes in TRS benefit provisions for the fiscal year ended June 30, 2003.

TRS pension benefit provisions have been established by chapters 41.32 and 41.34 RCW.

TRS is comprised of three separate plans for reporting purposes: Plan 1, Plan 2/3, and Plan 3. Plan 1 accounts for the defined benefits of Plan 1 members. Plan 2/3 accounts for the defined benefits of Plan 2 members and the defined benefit portion of benefits for Plan 3 members. Plan 3 accounts for the defined contribution portion of benefits for Plan 3 members. Although members can only be a member of either Plan 2 or Plan 3, the defined benefit portions of Plan 2 and Plan 3 are accounted for in the same pension trust fund. All assets of this Plan 2/3 defined benefit plan may legally be used to pay the defined benefits of any of the Plan 2 or Plan 3 members or beneficiaries, as defined by the terms of the plan. Therefore, Plan 2/3 is considered to be a single plan for reporting purposes.

### **School Employees' Retirement System (SERS)**

SERS is a cost-sharing multiple-employer retirement system comprised of two separate plans for membership purposes: Plan 2 is a defined benefit plan and Plan 3 is a combination defined benefit/defined contribution plan. As of September 1, 2000, the membership of classified school employees in PERS Plan 2 was transferred to SERS Plan 2. Those who joined on or after October 1, 1977, and by August 31, 2000, are SERS Plan 2 members unless they exercised an option to transfer their membership to Plan 3. SERS participants joining the system on or after September 1, 2000, and those who exercised their transfer option, are members of SERS Plan 3.

SERS defined benefit retirement benefits are financed from a combination of investment earnings and employer and employee contributions. Employee contributions to the SERS Plan 2 defined benefit plan accrue interest at a rate specified by DRS. During Fiscal Year 2003, the DRS-established rate on employee contributions was 5.5 percent compounded quarterly. Employees in SERS Plan 2 can elect to withdraw total employee contributions and interest thereon upon separation from SERS-covered employment. SERS Plan 3 defined contribution benefits are financed from employee contributions and investment earnings. Employees in SERS Plan 3 can elect to withdraw total employee contributions adjusted by earnings and losses from the investment of those contributions upon separation from SERS-covered employment.

The Legislature established SERS in 2000. Membership in the system includes all classified employees of school districts or educational service districts. SERS is comprised principally of non-state employees. SERS retirement benefit provisions are established in state statute and may be amended only by the State Legislature.

SERS Plan 2 retirement benefits are vested after an employee completes five years of eligible service. Plan 2 members may retire at the age of 65 with five years of service, or at the age of 55 with 20 years of service, with an allowance of 2 percent of the average final compensation (AFC) per year of service. (AFC is based on the greatest compensation during any eligible consecutive 60-month period.) Plan 2 retirements prior to the age of 65 receive reduced benefits. If retirement is at age 55 or older with at least 30 years of service, a 3 percent per year reduction applies; otherwise an actuarial reduction will apply. There is no cap on years of service credit; and a cost-of-living allowance is granted (indexed to the Seattle Consumer Price Index), capped at 3 percent annually.

SERS Plan 3 has a dual benefit structure. Employer contributions finance a defined benefit component, and member contributions finance a defined contribution component. The defined benefit portion provides a benefit calculated at 1 percent of the AFC per year of service. (AFC is based on the greatest compensation during any eligible consecutive 60-month period.) Plan 3 members become eligible for retirement if they have: at least ten years of service; or five years including 12 months that were earned after age 54; or five service credit years earned in PERS Plan 2 prior to September 1, 2000. Plan 3 retirements prior to the age of 65 receive reduced benefits. If retirement is at age 55 or older with at least 30 years of service, a 3 percent per year reduction applies; otherwise an actuarial reduction will apply. There is no cap on years of service credit; and Plan 3 provides the same cost-of-living allowance as Plan 2.

Refer to section I of this note for a description of the defined contribution component of SERS Plan 3.

SERS Plan 2 and Plan 3 provide disability benefits. There is no minimum amount of service credit required for eligibility. The Plan 2 allowance amount is 2 percent of the AFC for each year of service. For Plan 3 the allowance amount is 1 percent of the AFC for each year of service. Benefits are actuarially reduced for each year that the member's age is less than 65, and to reflect the choice of a survivor option.

Legislation passed in the 2003 session provides a \$150,000 death benefit to the estate of an employee of schools, higher education and state agencies who dies in the line of service, if found eligible by the Department of Labor and Industries. There were no other material changes in SERS benefit provisions for the fiscal year ended June 30, 2003.

SERS pension benefit provisions have been established by chapter 41.35 RCW.

SERS is comprised of two separate plans for reporting purposes: Plan 2/3 and Plan 3. Plan 2/3 accounts for the defined benefits of Plan 2 members and the defined benefit portion of benefits for Plan 3 members. Plan 3 accounts for the defined contribution portion of benefits for Plan 3 members. Although members can only be a member of either Plan 2 or Plan 3, the defined benefit portions of Plan 2 and Plan 3 are accounted for in the same pension trust fund. All assets of this Plan 2/3 defined benefit plan may legally be used to pay the defined benefits of any of the Plan 2 or Plan 3 members or beneficiaries, as defined by the terms of the plan. Therefore, Plan 2/3 is considered to be a single plan for reporting purposes.

#### **Law Enforcement Officers' and Fire Fighters' Retirement System (LEOFF)**

LEOFF is a cost-sharing multiple-employer retirement system comprised of two separate defined benefit plans. LEOFF participants who joined the system by September 30, 1977 are Plan 1 members. Those who joined on or after October 1, 1977, are Plan 2 members.

LEOFF defined benefit retirement benefits are financed from a combination of investment earnings, employer and employee contributions, and a special funding situation in which the state pays through state legislative appropriations. Employee contributions to the LEOFF Plan 1 and 2 defined benefit plans accrue interest at a rate specified by DRS. During Fiscal Year 2003, the DRS-established rate on employee contributions was 5.5 percent compounded quarterly. Employees in LEOFF Plan 1 and 2 can elect to withdraw total employee contributions and interest earnings thereon upon separation from LEOFF-covered employment.

LEOFF was established in 1970 by the Legislature. Membership includes all full-time, fully compensated, local law enforcement officers and firefighters. LEOFF membership is comprised primarily of non-state employees, with Department of Fish and Wildlife enforcement officers who were first included prospectively effective July 27, 2003, being a major exception. LEOFF retirement benefit provisions are established in state statute and may be amended only by the state Legislature.

LEOFF Plan 1 retirement benefits are vested after an employee completes five years of eligible service. Plan 1 members are eligible for retirement with five years of service at the age of 50. The benefit per year of service calculated as a percent of final average salary (FAS) is as follows:

Term of Service	Percent of FAS
20+	2.0%
10-19	1.5%
5-9	1.0%

The FAS is the basic monthly salary received at the time of retirement, provided a member has held the same position or rank for 12 months preceding the date of retirement. Otherwise, it is the average of the highest consecutive 24 months' salary within the last 10 years of service. If membership was established in LEOFF after February 18, 1974, the service retirement benefit is capped at 60 percent of FAS. A cost-of-living allowance is granted (indexed to the Seattle Consumer Price Index).

LEOFF Plan 2 retirement benefits are vested after an employee completes five years of eligible service. Plan 2 members may retire at the age of 50 with 20 years of service, or at the age of 53 with five years of service, with an allowance of 2 percent of the FAS per year of service (FAS is based on the highest consecutive 60 months). Plan 2 retirements prior to the age of 53 are reduced 3 percent for each year that the benefit commences prior to age 53. There is no cap on years of service credit; and a cost-of-living allowance is granted (indexed to the Seattle Consumer Price Index), capped at 3 percent annually.

LEOFF Plan 1 provides death and disability benefits. Death benefits for Plan 1 members on active duty consist of the following: (1) If eligible spouse, 50 percent of the FAS, plus 5 percent of FAS for each surviving child, with a limitation on the combined allowances of 60 percent of the FAS; or (2) If no eligible spouse, 30 percent of FAS for the first child plus 10 percent for each additional child, subject to a 60 percent limitation of FAS. In addition, a duty death benefit of \$150,000 is provided to Plan 1 and Plan 2 members.

The LEOFF Plan 1 disability allowance is 50 percent of the FAS plus 5 percent for each child up to a maximum of 60 percent. Upon recovery from disability before the age of 50, a member is restored to service with full credit for service while disabled. Upon recovery after the age of 50, the benefit continues as the greater of the member's disability allowance or service retirement allowance.

LEOFF Plan 2 provides non-duty disability benefits. There is no minimum amount of service credit required for eligibility. The Plan 2 allowance amount is 2 percent of the FAS for each year of service. Benefits are actuarially reduced for each year that the member's age is less than 53, and to reflect the choice of a survivor option.

Legislation passed in the 2003 session allows some members working as fire fighter emergency medical technicians (EMTs) to transfer service credit and contributions earned from PERS Plan 1 or Plan 2 to LEOFF Plan 2 if, while employed for a city, town, county or district, the EMT's job was relocated to a fire department from another city, town, county or district. Members electing to transfer EMT service credit are required to pay the difference between the contributions the employee paid to PERS Plan 1 or Plan 2 and the contributions that would have been paid by the employee had they been a member of LEOFF Plan 2, plus interest.

Other legislation passed in the 2003 session requires Department of Fish and Wildlife enforcement officers formerly in PERS Plan 2 or PERS Plan 3, to become members of LEOFF Plan 2, effective July 27, 2003. Service prior to the effective date will remain in PERS.

There were no other material changes in LEOFF benefit provisions for the fiscal year ended June 30, 2003.

LEOFF pension benefit provisions have been established by chapter 41.26 RCW.

### **Washington State Patrol Retirement System (WSPRS)**

WSPRS is a single-employer retirement system comprised of two defined benefit plans. WSPRS participants who joined the system by December 31, 2002, are Plan 1 members. Those who joined on or after January 1, 2003, are Plan 2 members.

WSPRS retirement benefits are financed from a combination of investment earnings and employer and employee contributions. Employee contributions to the WSPRS Plan 1 and Plan 2 defined benefit plan accrue interest at a rate specified by DRS. During Fiscal Year 2003, the DRS-established rate on employee contributions was 5.5 percent compounded annually and posted monthly. Employees in WSPRS Plan 1 and Plan



2 can elect to withdraw total employee contributions and interest earnings thereon upon separation from WSPRS-covered employment.

WSPRS was established by the Legislature in 1947. Legislation passed in the 2001 session created a Washington State Patrol Plan 2. Any commissioned employee of the Washington State Patrol is eligible to participate. WSPRS benefits are established in state statute and may be amended only by the state Legislature.

WSPRS retirement benefits are vested after an employee completes five years of eligible service. Members are eligible for retirement at the age of 55 with five years of service, or after 25 years of service. The annual pension is 2 percent of the average final salary (AFS), capped at 75 percent, per year of service. For Plan 1 members, AFS is based on the average of the two highest-paid years and excludes voluntary overtime. For Plan 2 members, AFS is based on the average of the five highest-paid years and excludes both voluntary overtime and cash-outs of annual and holiday leave. At retirement, Plan 2 members also have the option of selecting an actuarially reduced benefit in order to provide for post-retirement survivor benefits. A cost-of-living allowance is granted (indexed to the Seattle Consumer Price Index), capped at 3 percent annually.

WSPRS benefit provisions include death benefits; however, the system provides no disability benefits. Disability benefits may be available from the Washington State Patrol. If disability benefits are received, the member may be eligible to acquire service credit for the period of disability. Death benefits for Plan 1 members on active duty consist of the following: (1) If eligible spouse, 50 percent of the FAS, plus 5 percent of the FAS for each surviving child, with a limitation on the combined allowances of 60 percent of the FAS; or (2) If no eligible spouse, 30 percent of FAS for the first child plus 10 percent for each additional child, subject to a 60 percent limitation of FAS. Death benefits for active-duty Plan 2 members consist of the following: (1) If the member is single or has less than 10 years of service, the return of the member's accumulated contributions; or (2) If the member is married, has an eligible child, or has completed 10 years of service, a reduced benefit allowance reflecting a joint and 100 percent survivor option or 150 percent of the member's accumulated contributions, at the survivor's option. In addition, a duty death benefit of \$150,000 is provided to all WSPRS members.

There were no other material changes in WSPRS benefit provisions for the fiscal year ended June 30, 2003.

WSPRS pension benefit provisions have been established by chapter 43.43 RCW.

### Judicial Retirement System (JRS)

JRS is an agent multiple-employer retirement system comprised of a single defined benefit plan. JRS retirement benefits are financed on a pay-as-you-go basis from a combination of investment earnings, employer contributions, employee contributions, and a special funding situation in which the state pays the remaining contributions. JRS employees accrue no interest on contributions and may not elect to withdraw their contributions upon termination.

JRS was established by the Legislature in 1971. Membership includes judges elected or appointed to the Supreme Court, Court of Appeals, and Superior Courts on or after August 9, 1971. The system was closed to new entrants on July 1, 1988, with new judges joining PERS Plan 2. JRS retirement benefit provisions are established in state statute and may be amended only by the state Legislature.

JRS members are eligible for retirement at the age of 60 with 15 years of service, or at the age of 60 after 12 years of service (if the member left office involuntarily) with at least 15 years after beginning judicial service.

The benefit per year of service calculated as a percent of average final compensation (AFC) is as follows:

<u>Term of Service</u>	<u>Percent of AFC</u>
15+	3.5%
10-14	3.0%

Death and disability benefits are also provided. Eligibility for death benefits while on active duty requires ten or more years of service. A monthly spousal benefit is provided which is equal to 50 percent of the benefit a member would have received if retired. If the member is retired, the surviving spouse receives the greater of 50 percent of the member's retirement benefit or 25 percent of the AFC. For members with ten or more years of service, a disability benefit of 50 percent of AFC is provided.

There were no material changes in JRS benefit provisions for the fiscal year ended June 30, 2003.

JRS pension benefit provisions have been established by chapter 2.10 RCW.

### Judges' Retirement Fund (Judges)

The Judges' Retirement Fund is an agent multiple-employer retirement system comprised of a single defined benefit plan. Retirement benefits are financed on a pay-as-you-go basis from a combination of employee contributions, employer contributions, and a special funding situation in which the state pays the remaining contributions. Employees do not earn interest on their

contributions, nor can they elect to withdraw their contributions upon termination.

The Judges' Retirement Fund was created by the Legislature on March 22, 1937, pursuant to RCW 2.12, to provide retirement benefits to judges of the Supreme Court, Court of Appeals, or Superior Courts of the state of Washington. Subsequent legislation required that all judges first appointed or elected to office on or after August 9, 1971, enter the Judicial Retirement System. Judges' retirement benefit provisions are established in state statute and may be amended only by the State Legislature.

Judges' members are eligible for retirement at the age of 70 with ten years of service, or at any age with 18 years of service. Members are eligible to receive a partial retirement allowance after 12 years of credited service as a judge. With the exception of a partial retirement allowance, the member receives a benefit equal to one-half of the monthly salary being received as a judge at the time of retirement, or at the end of the term immediately prior to retirement if retirement occurs after the expiration of the member's term in office. A partial retirement allowance is based on the proportion of the member's 12 or more years of service in relation to 18 years of service.

There were no material changes in Judges' benefit provisions for the fiscal year ended June 30, 2003.

Judges' pension benefit provisions have been established by chapter 2.12 RCW.

### **The Volunteer Fire Fighters' Relief and Pension Fund (VFFRPF)**

VFFRPF is a cost-sharing multiple-employer retirement system that provides death and active duty disability benefits to all members, and optional defined benefit pension plan payments.

VFFRPF retirement benefits are financed from a combination of investment earnings, member contributions, municipality contributions, and a special funding situation where the state pays the remaining contributions. VFFRPF members accrue no interest on contributions and may elect to withdraw their contributions upon termination.

VFFRPF was created by the Legislature in 1945. Membership in the system requires volunteer firefighter service with a fire department of an electing municipality of Washington State.

Retirement benefits are established in state statute and may be amended only by the state Legislature. Since retirement benefits cover volunteer service, benefits are

paid based on years of service not salary. Members are vested after ten years of service.

After 25 years of active membership, members having reached the age of 65 and who have paid their annual retirement fee for 25 years are entitled to receive a monthly benefit of \$50 plus \$10 per year of service. The maximum monthly benefit is \$300. Reduced pensions are available for members under the age of 65 or with less than 25 years of service.

Death and active duty disability benefits are provided at no cost to the member. Death benefits in the line of duty consist of a lump sum of \$152,000. Funeral and burial expenses are also paid in a lump sum of \$2,000 for members on active duty. Members receiving disability benefits at the time of death shall be paid \$500. Members on active duty shall receive disability payments of \$2,550 per month for up to six months; thereafter, payments are reduced. Disabled members receive \$1,275 per month, their spouse \$255, and dependent children \$110. Benefit provisions for VFFRPF are established under the authority of chapter 41.24 RCW.

Effective July 1, 2001, the disability income benefits and the maximum survivor benefits under the Relief Plan are increased for increases in the CPI.

The benefit formula was changed from \$30 plus \$10 per year of service to \$50 plus \$10 per year of service. There were no other material changes in VFFRPF benefit provisions for the fiscal year ended June 30, 2003.

### **C. Funding Policies**

Contributions towards the amortization of the PERS 1 and TRS 1 unfunded actuarial accrued liability are suspended for the 2003-2005 biennium.

#### **Public Employees' Retirement System (PERS)**

Each biennium, the state Pension Funding Council adopts Plan 1 employer contribution rates, Plan 2 employer and employee contribution rates, and Plan 3 employer contribution rates. Employee contribution rates for Plan 1 are established by statute at 6 percent and do not vary from year to year. The employer and employee contribution rates for Plan 2 and the employer contribution rate for Plan 3 are developed by the Office of the State Actuary to fully fund Plan 2 and the defined benefit portion of Plan 3. All employers are required to contribute at the level established by the Legislature. There are no employer contributions to PERS Plan 3 defined contribution. Employees who participate in the defined contribution portion of PERS Plan 3 contribute to the defined contribution plan instead of the defined benefit portion of PERS Plan 3. The employee chooses from six rate options provided in statute ranging from 5 to 15 percent, two of the options are graduated rates

dependent on the employee's age. The Employee Retirement Benefits Board may adopt other options.

The methods used to determine the contribution requirements are established under state statute in accordance with chapters 41.40 and 41.45 RCW.

Required contribution rates (expressed as a percentage of current year covered payroll) at the close of Fiscal Year 2003 were as follows:

PERS Actual Contribution Rates

	PLAN 1	PLAN 2	PLAN 3
Employer Rates:			
State agencies*	1.32%	1.32%	1.32%**
Local governmental units*	1.32%	1.32%	1.32%**
State gov't elected officials*	1.87%	1.32%	1.32%**
Employee Rates:			
State agencies	6.00%	0.65%	***
Local governmental units	6.00%	0.65%	***
State gov't elected officials	7.50%	0.65%	***

\*Includes an administrative expense rate of 0.22 percent.

\*\*Plan 3 defined benefit portion only.

\*\*\*Variable from 5% to 15% based on rate selected by the member.

### Teachers' Retirement System (TRS)

Each biennium the state Pension Funding Council adopts Plan 1 employer contribution rates, Plan 2 employer and employee contribution rates, and Plan 3 employer contribution rates. Employee contribution rates for Plan 1 are established by statute at 6 percent and do not vary from year to year. The employer and employee contribution rates for Plan 2 and the employer contribution rate for Plan 3 are developed by the Office of the State Actuary to fully fund Plan 2 and the defined benefit portion of Plan 3. All employers are required to contribute at the level established by the Legislature. There are no employer contributions to TRS Plan 3 defined contribution. Employees who participate in the defined contribution portion of TRS Plan 3 contribute to the defined contribution plan instead of the defined benefit portion of TRS Plan 3. The employee chooses from six rate options provided in statute ranging from 5 to 15 percent, two of the options are graduated rates dependent on the employee's age. The Employee Retirement Benefits Board may adopt other options.

The methods used to determine the contribution requirements are established under state statute in accordance with chapters 41.32 and 41.45 RCW.

Required contribution rates (expressed as a percentage of current-year covered payroll) at the close of Fiscal Year 2003 were as follows:

TRS Actual Contribution Rates

	PLAN 1	PLAN 2	PLAN 3
Employer Rates *	1.27%	1.27%	1.27%**
Employee Rates:			
State agencies	6.00%	0.15%	***
Local governmental units	6.00%	0.15%	***
State gov't elected officials	7.50%	0.15%	***

\* Includes an administrative expense rate of 0.22 percent.

\*\* Plan 3 defined benefit portion only.

\*\*\* Variable from 5% to 15% based on rate selected by the member.

### School Employees' Retirement System (SERS)

Each biennium the state Pension Funding Council adopts Plan 2 employer and employee contribution rates and Plan 3 employer contribution rates. The employer and employee contribution rates for Plan 2 and the employer contribution rate for Plan 3 are developed by the Office of the State Actuary to fully fund Plan 2 and the defined benefit portion of Plan 3. All employers are required to contribute at the level established by the Legislature. There are no employer contributions to SERS Plan 3 defined contribution. Employees who participate in the defined contribution portion of SERS Plan 3 contribute to the defined contribution plan instead of the defined benefit portion of SERS Plan 3. The employee chooses from six rate options provided in statute ranging from 5 to 15 percent, two of the options are graduated rates dependent on the employee's age. The Employee Retirement Benefits Board may adopt other options.

The methods used to determine the contribution requirements are established under state statute in chapters 41.35 and 41.45 RCW.

Required contribution rates (expressed as a percentage of current year covered payroll) at the close of Fiscal Year 2003 were as follows:

SERS Actual Contribution Rates

	PLAN 2	PLAN 3
Employer Rates:		
State agencies*	1.18%	1.18%**
Local governmental units*	1.18%	1.18%**
Employee Rates:		
State Agencies	0.35%	***
Local Governmental Units	0.35%	***

\*Includes an administrative expense rate of 0.22 percent.

\*\*Plan 3 defined benefit portion only.

\*\*\*Variable from 5% to 15% based on rate selected by the member.

### Law Enforcement Officers' and Fire Fighters' Retirement System (LEOFF)

Beginning on July 1, 2000, Plan 1 employers and employees will contribute zero percent as long as the plan remains fully funded. Employer and employee contribution rates are developed by the Office of the State Actuary to fully fund the plan. Plan 2 employers and employees are required to pay at the level adopted by the Department of Retirement Systems in accordance with chapter 41.45 RCW. All employers are required to contribute at the level required by state statute.

Required contribution rates (expressed as a percentage of current year covered payroll) at the close of Fiscal Year 2003 were as follows:

LEOFF Actual Contribution Rates		
	PLAN 1	PLAN 2
Employer Rates:		
Ports and Universities*	NA	4.61%
Local governmental units*	0.22%	2.86%
Employee Rates:		
Ports and Universities	NA	4.39%
Local governmental units	NA	4.39%
State of Washington	NA	1.75%

\*Includes an administrative expense rate of 0.22 percent.

The Legislature, by means of a special funding arrangement, appropriated money from the state General Fund to supplement the current service liability and fund the prior service costs of Plan 1 in accordance with the requirements of the Pension Funding Council. However, this special funding situation is not mandated by the State Constitution and this funding requirement could be returned to the employers by a change of statute.

### Washington State Patrol Retirement System (WSPRS)

State statute (chapter 43.43 RCW) obligates employees to contribute at a fixed rate of 2 percent for Fiscal Year 2003. The Pension Funding Council in accordance with chapter 41.45 RCW adopts contribution rates for the employee and the state. The employee and the state are required to contribute at the level required by state statute.

Required contribution rates (expressed as a percentage of current year covered payroll) at the close of Fiscal Year 2003 were as follows:

WSPRS Actual Contribution Rates		
	PLAN 1	PLAN 2
Employer Contributions	0.00%	0.00%
Employee Contributions	2.00%	2.00%

### Judicial Retirement System (JRS)

Contributions made are based on rates set in chapter 2.10 RCW. By statute, employees are required to contribute 7.5 percent with an equal amount contributed by the state. In addition, the state guarantees the solvency of the JRS on a pay-as-you-go basis. Each biennium, the Legislature, through biennial appropriations from the state General Fund, contributes amounts sufficient to meet benefit payment requirements. For Fiscal Year 2003, the state contributed \$6 million.

### Judges' Retirement Fund (Judges)

Contributions made are based on rates set in chapter 2.12 RCW. By statute, employees are required to contribute 6.5 percent with an equal amount contributed by the state. In addition, the state guarantees the solvency of the Judges' Retirement Fund on a pay-as-you-go basis. Each biennium, the Legislature, through biennial appropriations from the state General Fund, contributes amounts sufficient to meet benefit payment requirements. For Fiscal Year 2003, the state contributed \$.25 million.

### The Volunteer Fire Fighters' Relief and Pension Fund (VFFRPF)

The retirement provisions of VFFRPF is funded through member contributions of \$30 per year, employer contributions of \$30 per year, and 40 percent of the Fire Insurance Premium Tax, as per chapter 41.24 RCW. VFFRPF members earn no interest on contributions and may elect to withdraw their contributions upon termination. The death and disability provisions of VFFRPF are funded by an employer contribution rate of \$10 per member.

Administrative expenses are funded through fire insurance premium taxes and are maintained in a separate fund. Amounts not needed for administrative expenses are transferred to VFFRPF.

### D. Employer Contributions Required and Paid

The following table presents the state of Washington's required contributions in millions of dollars to cost-sharing plans in accordance with the funding policy. All contributions required by the funding method were paid.

	2003	2002	2001
PERS Plan 1	\$28.8	\$35.3	\$94.0
PERS Plan 2/3	18.5	26.2	58.2
TRS Plan 1	0.6	1.7	3.5
TRS Plan 2/3	0.1	0.4	0.3
SERS Plan 2/3	0.0	0.0	0.0
LEOFF Plan 1	0.0	0.0	0.0
LEOFF Plan 2	16.6	15.8	21.1
VFFRPF	3.3	3.3	3.3

There are no long-term contracts for contributions for any of the retirement plans administered by the state.

### E. Annual Pension Cost and Net Pension Obligation

The state's annual pension cost and net pension obligation (NPO), in millions, to the plans listed for the current year were as follows:

	WSPRS	JRS	Judges
Annual Required Contribution	\$0.0	\$16.2	\$0.1
Interest on NPO	(2.4)	3.6	(0.2)
Adjustment to annual required contribution	3.6	(8.4)	0.5
Annual Pension Cost	1.2	11.4	0.4
Less Contributions Made	0.0	6.2	0.3
Increase (decrease) in NPO	1.2	5.2	0.1
NPO at beginning of year	(29.6)	44.7	(2.8)
NPO at end of year	(28.4)	49.9	(2.7)

The valuation date for the plans is September 30, 2002. The actuarial cost method for the WSPRS is aggregate and for JRS and Judges is entry age normal. The unfunded amount is being amortized as a level dollar amount to December 31, 2008, for JRS. All other methods and assumptions are the same as used in funding and disclosed in "Notes to the Required Supplementary Information – Defined Benefit Pension Plans."

### F. Three Year Trend Information

The following table presents three-year trend information in millions for the plans listed:

	2003	2002	2001
<b>WSPRS</b>			
Annual Pension Cost	\$1.2	\$1.3	\$1.4
% of APC contributed	0.0	0.0	0.0
NPO	\$(28.4)	\$(29.6)	\$(30.9)
<b>JRS</b>			
Annual Pension Cost	\$11.4	\$10.7	\$10.6
% of APC contributed	54.6	57.9	68.9
NPO	\$49.9	\$44.7	\$40.1
<b>Judges</b>			
Annual Pension Cost	\$0.4	\$0.5	\$0.4
% of APC contributed	75.0	60.0	200.0
NPO	\$(2.7)	\$(2.8)	\$(3.0)

There are no long-term contracts for contributions for any of the retirement plans administered by the state.

### G. Changes in Actuarial Assumptions and Methods

The method used to determine the actuarial value of assets was changed from a 4-year smoothing method to a graded 1 to 8-year smoothing method, depending on the size of the annual investment gain or loss, for all plans except VFFRPF, which continues to use the prior 4-year smoothing method, and JRS and Judges which continue to use market value.

### H. Changes in Benefit Provisions

As noted in Note 11B, the 2003 legislative session provided for the following changes in benefit provisions: allowing some members working as fire fighter emergency medical technicians (EMTs) to transfer service credit and contributions earned from PERS Plan 1 or Plan 2 to LEOFF Plan 2, allowing Department of Fish and Wildlife enforcement officers membership in LEOFF 2, and permanently adopting the \$150,000 death benefit to members of PERS, SERS and TRS which was to expire on June 30, 2003. These changes had no impact on PERS and TRS contribution rates and only a small impact on the LEOFF and SERS contribution rates.

### I. Defined Contribution Plans

#### Public Employees' Retirement System Plan 3 (PERS 3)

The Public Employees' Retirement System (PERS) Plan 3 is a combination defined benefit/defined contribution plan administered by the state through the Department of Retirement Systems (DRS). Eligible employees include: elected officials; state employees; employees of the Supreme, Appeals, and Superior Courts (other than judges currently in a judicial retirement system); employees of legislative committees; community and technical colleges, college and university employees not in national higher education retirement programs such as Teachers' Insurance and Annuity Association/College Retirement Equity Fund (TIAA/CREF); judges of district and municipal courts; and employees of local governments. PERS participants who joined on or after October 1, 1977, and by either, February 28, 2002, for state and higher education employees, or August 31, 2002, for local government employees, are Plan 2 members unless they exercise an option to transfer their membership to Plan 3. PERS participants who joined the system on or after March 1, 2002, for state and higher education employees, or September 1, 2002, for local government employees have the option of choosing membership in either PERS Plan 2 or PERS Plan 3. The option must be exercised within 90 days of employment. An employee is reported in Plan 2 until a choice is made. Employees who fail to choose within 90 days default to PERS Plan 3. Refer to section B of this note for PERS plan descriptions.

PERS Plan 3 has a dual benefit structure. Employer contributions finance a defined benefit component, and member contributions finance a defined contribution component. As established by RCW 41.40, employee contribution rates to the defined contribution component range from 5 to 15 percent of salaries based on age. There are currently no requirements for employer contributions to the defined contribution component of PERS Plan 3.

PERS Plan 3 defined contribution retirement benefits are solely dependent upon the results of investment activities. Members may elect to self-direct the investment of their contributions as authorized by the Employee Retirement Benefits Board. Any expenses caused in conjunction with self-directed investments are to be paid by members. Absent a member's self-direction, PERS Plan 3 investments are made in the same portfolio as that of the PERS 2/3 defined benefit plan.

For Fiscal Year 2003, employee contributions required and made were \$32.6 million, and plan refunds paid out were \$5.7 million.

### **Teachers' Retirement System Plan 3 (TRS 3)**

The Teachers' Retirement System (TRS) Plan 3 is a combination defined benefit/defined contribution plan administered by the state through the Department of Retirement Systems (DRS). Eligible employees include certificated employees in grades K-12 in the public schools. TRS participants who joined on or after October 1, 1977, and by June 30, 1996, are Plan 2 members unless they exercised an option to transfer their membership to Plan 3. TRS participants joining the system on or after July 1, 1996, and those who exercised their transfer option, are members of TRS Plan 3. Refer to Section B of this note for TRS plan descriptions.

TRS Plan 3 has a dual benefit structure. Employer contributions finance a defined benefit component, and member contributions finance a defined contribution component. As established by RCW 41.34, employee contribution rates to the defined contribution component range from 5 to 15 percent of salaries based on member choice. There are currently no requirements for employer contributions to the defined contribution component of TRS Plan 3.

TRS Plan 3 defined contribution retirement benefits are solely dependent upon the results of investment activities. Members may elect to self-direct the investment of their contributions as authorized by the Employee Retirement Benefits Board. Any expenses caused in conjunction with self-directed investments are to be paid by members. Absent a member's self-direction, TRS Plan 3 investments are made in the same portfolio as that of the TRS 2/3 defined benefit plan.

For Fiscal Year 2003, employee contributions required and made were \$168.2 million and plan refunds paid out were \$19.3 million.

### **School Employees' Retirement System Plan 3 (SERS 3)**

The School Employees' Retirement System (SERS) Plan 3 is a combination defined benefit/defined contribution plan administered by the state through the Department of Retirement Systems (DRS). Eligible employees include classified employees of school districts and educational service districts who joined PERS Plan 2 on or after October 1, 1977, and by August 31, 2000, and were transferred to SERS Plan 2 on September 1, 2000. Members transferred from PERS Plan 2 to SERS Plan 2 may exercise an option to transfer their membership to SERS Plan 3. SERS participants joining the system on or after September 1, 2000, are also members of SERS Plan 3. Refer to Section B of this note for SERS plan descriptions.

SERS Plan 3 has a dual benefit structure. Employer contributions finance a defined benefit component, and member contributions finance a defined contribution component. As established by RCW 41.35, employee contribution rates to the defined contribution component range from 5 to 15 percent of salaries based on member choice. There are currently no requirements for employer contributions to the defined contribution component of SERS Plan 3.

SERS Plan 3 defined contribution retirement benefits are solely dependent upon the results of investment activities. Members may elect to self-direct the investment of their contributions as authorized by the Employee Retirement Benefits Board. Any expenses caused in conjunction with self-directed investments are to be paid by members. Absent a member's self-direction, SERS Plan 3 investments are made in the same portfolio as that of the SERS 2/3 defined benefit plan.

For Fiscal Year 2003, employee contributions required and made were \$44.3 million and plan refunds paid out were \$11.3 million.

### **Judicial Retirement Account (JRA)**

The Judicial Retirement Account Plan was established by the Legislature in 1988 to provide supplemental retirement benefits. It is a defined contribution plan administered by the state Office of the Administrator for the Courts, under the direction of the Board for Judicial Administration. Membership includes judges elected or appointed to the Supreme Court, Court of Appeals, and Superior Courts, and who are members of the PERS for their services as a judge. Vesting is full and immediate. There are three participating employers in JRA.

Employee contributions equal 2.5 percent of covered salary and the state, as employer, matches this amount. Contributions are collected by the Office of the Administrator for the Courts. The employer and employee obligations to contribute are established per chapter 2.14 RCW. Current-year covered payroll for JRA employees was \$22.3 million for the fiscal year ended June 30, 2003. For Fiscal Year 2003, the contribution requirement for JRA was \$1.1 million. Actual employer and employee contributions were \$556 thousand each, for a total of \$1.1 million. Plan benefits paid out for Fiscal Year 2003 totaled \$168 thousand.

A JRA member who separates from judicial service for any reason is entitled to receive a lump-sum distribution of the accumulated contributions. If a member dies, the amount of accumulated contributions standing to the member's credit at the time of the member's death shall be paid to such a person or persons having an insurable interest in the member's life, per written designation of the member.

**Teachers' Insurance and Annuity  
Association/College Retirement Equity Fund  
(TIAA/CREF)**

TIAA/CREF, privately administered defined contribution plans, provide individual retirement fund contracts for each eligible employee. There are 38 state participating employers in the TIAA/CREF plan. Eligible employees include higher education faculty and other positions as designated by each institution; participation was established under chapter 28B.10 RCW. The employee must commence participation within the first two years of employment. Once eligible to participate in this system, members are vested immediately.

Employee contribution rates, which are based on age, range from 5 to 10 percent of salary. These rates are matched by the institution and sent to TIAA/CREF. The employer and employee obligations to contribute are established per chapter 28B.10 RCW. For Fiscal Year 2003, covered payroll for TIAA/CREF employees was \$1.2 billion and the contribution requirement for TIAA/CREF was \$202 million. Actual employer and

employee contributions were \$101 million each, for a total of \$202 million. These contribution amounts represent approximately 8 percent of covered payroll for employers and employees.

TIAA/CREF benefits are payable upon termination at the member's option unless the participant is reemployed in another institution which participates in TIAA/CREF. Upon retirement, participant accumulations are used to purchase an annuity. The benefits are determined as follows: TIAA - accumulations are converted to a fixed guaranteed annuity payable for life. In addition to the guaranteed annuity, a dividend payment is declared each year depending on investment performance; CREF - at retirement the value of the fund is converted to a variable annuity. This means the annuity is not guaranteed but rises and falls with the value of equity investments.

**J. Plan Net Assets and Changes in Plan Net Assets**

Pension plan investments are presented at fair value. The fair value of investments is based on published market prices and quotations from major investment brokers at current exchange rates, as available. Privately held mortgages have been valued at cost which approximates fair market value. The fair value of real estate investments has been estimated based on independent appraisals. Private equity investments are valued by independent investment advisors based on an analysis of the audited financial statements of the underlying partnerships. The pension funds have no investments of any commercial or industrial organization whose market value equals five percent or more of each plan's net assets.

The Combining Statement of Plan Net Assets that follows presents the principal components of receivables, investments, and liabilities.

The Combining Statement of Changes in Plan Net Assets presents the additions and deductions to plan net assets.

## Combining Statement of Plan Net Assets

### Pension and Other Employee Benefit Funds

June 30, 2003

(expressed in thousands)

	PERS Plan 1	PERS Plan 2/3 Defined Benefit	PERS Plan 3 Defined Contribution	TRS Plan 1	TRS Plan 2/3 Defined Benefit	TRS Plan 3 Defined Contribution	SERS Plan 2/3 Defined Benefit
<b>Assets:</b>							
<b>Cash and pooled investments</b>	\$ 5,934	\$ -	\$ 342	\$ 5,010	\$ 619	\$ 2,720	\$ 355
<b>Receivables:</b>							
Interest and dividends	24,794	27,010	390	21,022	9,217	2,683	3,726
Due from other funds	2,145	441	240,888	933	3,071	10,473	743
Due from other governments	5,522	6,305	2,238	4,010	2,120	11,117	1,232
Other (net of allowance)	5,939	5,768	82	4,809	1,946	565	787
<b>Total Receivables</b>	38,400	39,524	243,598	30,774	16,354	24,838	6,488
<b>Investments, Noncurrent:</b>							
Asset backed securities	40,277	43,932	640	34,156	14,963	4,396	6,047
Collateralized mort oblig	367,220	400,542	5,835	311,410	136,420	40,082	55,134
Commercial paper	-	-	-	-	-	-	-
Corporate bonds	910,732	993,371	14,470	772,318	338,331	99,406	136,737
Corporate stock	418,280	456,234	6,646	354,709	155,388	45,655	62,800
Govt securities domestic	298,545	325,635	4,744	253,172	110,907	32,586	44,823
Govt securities foreign	44,300	48,319	704	37,567	16,457	4,835	6,651
Government bonds	1,339	1,461	21	1,136	498	146	201
Repurchase agreements	1,453	154	-	1,120	471	-	159
Certificates of deposit	33,253	36,270	528	28,199	12,353	3,629	4,993
Mutual funds	3,582,638	3,907,726	361,176	3,038,149	1,330,926	1,250,000	537,896
Mortgages	314,022	342,517	4,990	266,297	116,657	34,275	47,147
Real estate	810,018	883,519	12,870	686,911	300,916	88,413	121,616
Private equity	1,244,320	1,357,229	19,771	1,055,208	462,257	135,817	186,821
Investments on loan	301,433	328,785	4,790	255,621	111,980	32,901	45,257
Short term investments	569,158	629,244	7,809	483,905	226,231	57,570	91,712
Other noncurrent investments	50	4	-	38	16	-	5
<b>Total Investments, Noncurrent</b>	8,937,038	9,754,942	444,994	7,579,916	3,334,771	1,829,711	1,347,999
<b>Total Assets</b>	\$ 8,981,372	\$ 9,794,466	\$ 688,934	\$ 7,615,700	\$ 3,351,744	\$ 1,857,269	\$ 1,354,842
<b>Liabilities:</b>							
Obligations under security							
lending agreements	\$ 320,664	\$ 348,379	\$ 5,024	\$ 271,818	\$ 119,300	\$ 34,597	\$ 48,203
Accrued liabilities	13,675	4,883	53	11,059	1,612	365	651
Due to other funds	438	244,589	437	394	12,384	3,069	4,795
<b>Total Liabilities</b>	334,777	597,851	5,514	283,271	133,296	38,031	53,649
<b>Net Assets</b>							
Net Assets Held in Trust for:							
Pension Benefits	8,646,595	9,196,615	683,420	7,332,429	3,218,448	1,819,238	1,301,193
(Schedule of funding progress by plan begins on page C94)							
Deferred Compensation Participants							
<b>Total Net Assets</b>	\$ 8,646,595	\$ 9,196,615	\$ 683,420	\$ 7,332,429	\$ 3,218,448	\$ 1,819,238	\$ 1,301,193



State of Washington

SERS Plan 3 Defined Contribution	LEOFF Plan 1	LEOFF Plan 2	WSPRS Plan 1	JRS	JRA	Judges	VFFRPF	Deferred Compensation	Total
\$ 697	\$ 1,912	\$ 705	\$ 480	\$ 325	\$ 7	\$ 4,491	\$ 9,398	\$ 321	\$ 33,316
1,007	12,373	6,969	1,705	7	-	-	277	-	111,180
3,898	5	2	1	1	-	10	23	1	262,635
3,514	-	4,350	53	16	-	-	-	-	40,477
213	2,669	1,509	359	5	-	4	3,358	1,382	29,395
8,632	15,047	12,830	2,118	29	-	14	3,658	1,383	443,687
1,653	20,111	11,338	2,773	-	-	-	451	-	180,737
15,072	183,355	103,374	25,277	-	-	-	4,109	-	1,647,830
-	-	-	-	-	-	-	-	-	-
37,381	454,735	256,376	62,689	-	-	-	10,191	-	4,086,737
17,168	208,850	117,748	28,792	-	-	-	4,680	-	1,876,950
12,254	149,065	84,042	20,550	-	-	-	3,340	-	1,339,663
1,818	22,119	12,471	3,049	-	-	-	496	-	198,786
55	669	377	92	-	-	-	15	-	6,010
-	570	104	77	52	1	620	1,303	44	6,128
1,365	16,603	9,361	2,289	-	-	-	372	-	149,215
311,259	1,788,836	1,008,533	246,606	-	-	-	40,087	-	17,403,832
12,889	156,793	88,399	21,615	-	-	-	3,514	-	1,409,115
33,247	404,447	228,025	55,756	-	-	-	9,064	-	3,634,802
51,073	621,297	350,283	85,651	-	-	-	13,923	-	5,583,650
12,372	150,508	84,855	20,749	-	-	-	3,373	-	1,352,624
20,850	284,179	166,827	39,807	6,483	-	-	6,356	-	2,590,131
-	20	3	3	2	10,634	22	45	1,461,484	1,472,326
528,456	4,462,157	2,522,116	615,775	6,537	10,635	642	101,319	1,461,528	42,938,536
\$ 537,785	\$ 4,479,116	\$ 2,535,651	\$ 618,373	\$ 6,891	\$ 10,642	\$ 5,147	\$ 114,375	\$ 1,463,232	\$ 43,415,539
\$ 12,984	\$ 159,955	\$ 89,964	\$ 22,050	\$ 52	\$ 1	\$ 620	\$ 4,875	\$ 44	\$ 1,438,530
137	3,238	988	625	139	-	12	48	245	37,730
743	88	343	5	-	-	-	9	8	267,302
13,864	163,281	91,295	22,680	191	1	632	4,932	297	1,743,562
523,921	4,315,835	2,444,356	595,693	6,700	10,641	4,515	109,443		40,209,042
								1,462,935	1,462,935
\$ 523,921	\$ 4,315,835	\$ 2,444,356	\$ 595,693	\$ 6,700	\$ 10,641	\$ 4,515	\$ 109,443	\$ 1,462,935	\$ 41,671,977

## Combining Statement of Changes in Plan Net Assets

### Pension and Other Employee Benefit Funds

For the Fiscal Year Ended June 30, 2003

(expressed in thousands)

	PERS Plan 1	PERS Plan 2/3 Defined Benefit	PERS Plan 3 Defined Contribution	TRS Plan 1	TRS Plan 2/3 Defined Benefit	TRS Plan 3 Defined Contribution	SERS Plan 2/3 Defined Benefit
<b>Additions:</b>							
Contributions:							
Employers	\$ 56,619	\$ 38,287	\$ -	\$ 20,358	\$ 18,225	\$ -	\$ 6,154
Members	66,870	36,668	32,634	48,585	931	168,241	1,913
State	-	-	-	-	-	-	-
Participants	-	-	-	-	-	-	-
<b>Total Contributions</b>	<b>123,489</b>	<b>74,955</b>	<b>32,634</b>	<b>68,943</b>	<b>19,156</b>	<b>168,241</b>	<b>8,067</b>
Investment Income:							
Net appreciation (depreciation) in fair value	115,168	148,785	12,310	100,949	57,869	25,419	23,452
Interest and dividends	225,317	238,274	6,897	190,783	86,590	18,550	35,317
Less: Investment expenses	(19,698)	(21,145)	(428)	(16,676)	(8,332)	(1,943)	(3,353)
<b>Net Investment Income</b>	<b>320,787</b>	<b>365,914</b>	<b>18,779</b>	<b>275,056</b>	<b>136,127</b>	<b>42,026</b>	<b>55,416</b>
Transfers from other pension plans	153	222	609,477	51	236	775	1,900
Other additions	-	-	-	-	-	-	-
<b>Total Additions</b>	<b>444,429</b>	<b>441,091</b>	<b>660,890</b>	<b>344,050</b>	<b>155,519</b>	<b>211,042</b>	<b>65,383</b>
<b>Deductions:</b>							
Pension benefits	776,683	72,460	-	689,253	10,861	-	4,305
Pension refunds	5,677	30,835	5,737	1,521	3,537	19,331	2,220
Transfers to other pension plans	25	611,721	207	-	807	238	329
Administrative expenses	429	161	-	174	102	-	26
Distributions to participants	-	-	-	-	-	-	-
<b>Total Deductions</b>	<b>782,814</b>	<b>715,177</b>	<b>5,944</b>	<b>690,948</b>	<b>15,307</b>	<b>19,569</b>	<b>6,880</b>
<b>Net Increase</b>	<b>(338,385)</b>	<b>(274,086)</b>	<b>654,946</b>	<b>(346,898)</b>	<b>140,212</b>	<b>191,473</b>	<b>58,503</b>
<b>Net Assets - Beginning</b>	<b>8,984,980</b>	<b>9,470,701</b>	<b>28,474</b>	<b>7,679,327</b>	<b>3,078,236</b>	<b>1,627,765</b>	<b>1,242,690</b>
<b>Net Assets - Ending</b>	<b>\$ 8,646,595</b>	<b>\$ 9,196,615</b>	<b>\$ 683,420</b>	<b>\$ 7,332,429</b>	<b>\$ 3,218,448</b>	<b>\$ 1,819,238</b>	<b>\$ 1,301,193</b>

State of Washington

SERS Plan 3 Defined Contribution	LEOFF Plan 1	LEOFF Plan 2	WSPRS Plan 1	JRS	JRA	Judges	VFFRPF	Deferred Compensation	Total
\$ -	\$ 62	\$ 25,583	\$ -	\$ 215	\$ 556	\$ 6	\$ 777	\$ -	\$ 166,842
44,293	78	41,588	1,314	215	556	6	154	-	444,046
-	-	16,404	-	6,000	-	250	3,300	-	25,954
-	-	-	-	-	-	-	-	135,901	135,901
44,293	140	83,575	1,314	6,430	1,112	262	4,231	135,901	772,743
7,762	60,416	43,770	8,901	(1)	111	(15)	1,276	5,266	611,438
6,865	111,560	60,105	15,212	125	278	134	2,776	37,870	1,036,653
(487)	(9,756)	(5,248)	(1,330)	(8)	-	(10)	(240)	-	(88,654)
14,140	162,220	98,627	22,783	116	389	109	3,812	43,136	1,559,437
317	1	140	121	-	-	-	-	-	613,393
-	-	-	-	-	8	-	-	1,188	1,196
58,750	162,361	182,342	24,218	6,546	1,509	371	8,043	180,225	2,946,769
-	264,618	4,058	24,047	8,279	168	639	7,543	-	1,862,914
11,328	158	5,125	221	-	-	-	18	-	85,708
66	-	-	-	-	-	-	-	-	613,393
-	212	69	22	-	12	-	52	1,741	3,000
-	-	-	-	-	-	-	-	68,469	68,469
11,394	264,988	9,252	24,290	8,279	180	639	7,613	70,210	2,633,484
47,356	(102,627)	173,090	(72)	(1,733)	1,329	(268)	430	110,015	313,285
476,565	4,418,462	2,271,266	595,765	8,433	9,312	4,783	109,013	1,352,920	41,358,692
\$ 523,921	\$ 4,315,835	\$ 2,444,356	\$ 595,693	\$ 6,700	\$ 10,641	\$ 4,515	\$ 109,443	\$ 1,462,935	\$ 41,671,977

## Note 12 - Commitments and Contingencies

### A. Construction and Other Commitments

Outstanding commitments related to state facility construction, improvement, and/or renovation totaled \$2.2 billion at June 30, 2003.

### B. Summary of Significant Litigation

The state and its agencies are parties to numerous routine legal proceedings that normally occur in governmental operations. At any given point, there may be numerous lawsuits involving state agencies that could impact expenditures. There is a recurring volume of tort and other claims for compensation and damages against the state and some specific state agencies, including the Departments of Transportation, Social and Health Services, and the University of Washington. There are risk management funds reserved by the state for these claims and insurance is available to pay a portion of damages for certain types of claims. There has been a trend over the past few years of higher jury verdicts on certain types of damage claims. The collective impact of these claims, however, is not likely to have a material impact on state revenues or expenditures.

#### Social Service Program Administration Litigation

During the reporting period, there have been additional challenges or developments in pending cases involving the administration of state social service programs. These include:

*Pierce County, et al. v. DSHS, et al.* This case is a challenge to the state's mental health system, which contemplates a joint state-local responsibility for providing a continuum of services. The county asserts that the state agency and the Legislature have failed in their duty to provide care for the mentally ill and developmentally disabled. If relief is granted to the plaintiff, it is difficult to estimate the cost to the agency to comply with the court order.

*Arc of Washington v. Quasim; Boyle v. Braddock.* Both of these cases involve challenges to DSHS's administration of programs for developmentally disabled clients. A proposed settlement in the *Arc* case was rejected by the federal court and the case was dismissed. An appeal was taken by plaintiffs to the Ninth Circuit Court of Appeals. The *Boyle* case is a related class action, also dismissed by the federal district court and with an appeal also pending. Biennial costs of providing the expanded program services sought by the so far unsuccessful plaintiffs range from approximately \$165 to \$222 million.

*Braam v. State.* In May 2002, the Whatcom County Superior Court entered an injunction mandating significant changes to the state's foster care system. Although most of the injunction was stayed pending appeal, DSHS estimates it would cost approximately \$60 million per year to comply with the injunction. The state is awaiting a decision from the Washington State Supreme Court on its appeal.

*Keffeler v. DSHS.* This is a class action challenging DSHS's authority when acting as a foster child's representative to use Social Security benefits for the costs of foster care. In February 2003, the United States Supreme Court upheld the state's position, but remanded the case to the Washington State Supreme Court for further proceedings regarding the constitutionality of the program. DSHS currently receives about \$9 million a year from the Social Security Administration for foster care costs. It is difficult to quantify the risk and possible liability to the state if the next phase of *Keffeler* is unsuccessful.

*Townsend v. Braddock.* This is a class action on behalf of elderly and disabled adults under the Americans with Disabilities Act (ADA). At issue is whether there will be an expansion of eligibility for a home and community based care program (COPES-like program). Potential costs to the state are unknown. The case is in active settlement discussions, after a summary judgment ruling in favor of the state was reversed on appeal.

#### Higher Education Litigation

There have been a series of lawsuits challenging personnel and administrative practices by the State Board for Community and Technical Colleges. Several have been successfully defended or settled. In the most recent case, part-time faculty sought state-paid health care benefits during the summer quarter. In June 2003, the Washington State Supreme Court ruled in favor of the faculty plaintiffs. Further action has been stayed pending settlement evaluation and negotiations. Approximate value of the benefits owed to plaintiffs is in the range of \$20 to \$40 million, an amount that is significantly higher than the likely settlement value.

#### Personnel Administration Litigation

*McGinnis v. State.* This is a class action wage involving all employees working in straight hour shifts at all state institutions. Plaintiffs claim they have not been provided adequate meal or rest periods. The state won on summary judgment after legislative amendment of the relevant statute, and an appeal was taken by the employee class directly to the Washington State Supreme Court, where it is now pending. The potential

compensation claim could exceed \$100 million if the state does not continue to prevail on appeal.

#### Tax and Medical Assistance Litigation

While there is a recurring volume of lawsuits seeking refunds of taxes paid to the state, there are currently no pending cases of such significance that they should be reported at this time. Similarly, there have in the past been a number of cases involving Medicaid reimbursement claims of significant magnitude. However, at this time those cases have been or are near settlement in amounts that do not require discussion in this report.

### **C. Federal Assistance**

The state has received federal financial assistance for specific purposes that are generally subject to review or audit by the grantor agencies. Entitlement to this assistance is generally conditional upon compliance with the terms and conditions of grant agreements and applicable federal regulations, including the expenditure of assistance for allowable purposes. Any disallowance resulting from a review or audit may become a liability of the state. The state does estimate and recognize a claims and judgments liability for disallowances when determined by the grantor agency or for probable disallowances based on experience pertaining to these grants; however, these recognized liabilities and any unrecognized disallowances are considered immaterial to the state's overall financial condition.

### **D. Arbitrage Rebate**

Rebatable arbitrage is defined by the Internal Revenue Service Code Section 148 as earnings on investments purchased from the gross proceeds of a bond issue that are in excess of the amount that would have been earned if the investments were invested at a yield equal to the yield on the bond issue. The rebatable arbitrage must be paid to the federal government. State agencies and universities responsible for investments from bond proceeds carefully monitor their investments to restrict earnings to a yield less than the bond issue, and therefore limit any state arbitrage liability. The state estimates that rebatable arbitrage liability, if any, will be immaterial to its overall financial condition.

### **E. Other Commitments and Contingencies**

#### School Bond Guarantee Program

Washington voters passed a constitutional amendment in November 1999, creating the Washington State School

Bond Guarantee Program. The program's purpose is to provide savings to state taxpayers by pledging the full faith and credit of the state of Washington to the full and timely payment of voter-approved school district general obligation bonds in the event a school district is unable to make a payment. The issuing school district remains responsible for the repayment of the bonds, including any payment the state makes under the guarantee.

The State Treasurer introduced the School Bond Guarantee Program in March 2000. At the end of Fiscal Year 2003, the state had guaranteed 122 school districts' voter-approved general obligation debt with a total outstanding principal of \$2.6 billion. The state estimates that school bond guarantee liability, if any, will be immaterial to its overall financial condition.

#### Local Option Capital Asset Lending Program (LOCAL)

On September 1, 1998, the state lease-purchase program was extended to local governments seeking low cost financing of essential equipment. The program allows local governments to pool their financing requests together with Washington State agencies in Certificates of Participation (COPs). Refer to Note 7.B for the state's COP disclosure. These COP's do not constitute a debt or pledge of the faith and credit of the state, rather local governments pledge their full faith and credit in a general obligation pledge. In the event that any local government fails to make any payment, the state is obligated to withhold an amount sufficient to make such payment from the local government's share, if any, of state revenues or other amounts authorized or required by law to be distributed by the state to such local government, if otherwise legally permissible. Upon failure of any local government to make a payment, the state is further obligated, to the extent of legally available appropriated funds to make such payment on behalf of such local government. The local government remains obligated to make all COP payments and reimburse the state for any conditional payments.

As of June 30, 2003, outstanding certificates of participation notes totaled \$34.9 million for 166 local governments participating in LOCAL. The state estimates that LOCAL program liability, if any, will be immaterial to its overall financial condition.

## Note 13 - Subsequent Events

### A. Bond Issues

In August 2003, the state issued \$271.4 million in Various Purpose General Obligation Bonds, Series 2004A, \$200 million in Motor Vehicle Fuel Tax General Obligation Bonds, Series 2004B, and \$110 million in Motor Vehicle Fuel Tax General Obligation Bonds, Series 2004C.

In October 2003, the state issued \$20 million in General Obligation Taxable Bonds, Series 2004T.

In October 2003, the state issued \$124 million in Various Purpose General Obligation Refunding Bonds, Series 2004A, and \$57 million in Motor Vehicle Fuel Tax General Obligation Refunding Bonds, Series R-2004B.

### B. Certificates of Participation

In September 2003, the state issued \$5.9 million in Certificates of Participation for various state and local government equipment purchases, Series 2003C.

In December 2003, the state issued \$3.9 million in Certificates of Participation for various state and local

government equipment and real estate purchases, Series 2003G.

### C. Office Building Lease

The 2001 Legislature authorized the state to lease-develop an office building in Tumwater, Washington. On October 23, 2003, the state entered into a ground lease and a lease agreement with Tumwater Office Properties (TOP), a Washington nonprofit corporation. The agreements call for TOP to design and construct an office building and to finance it with tax-exempt obligations that meet the requirements of Revenue Ruling 63-20 and Revenue Procedure 82-26 issued by the Internal Revenue Service. The state is required to make monthly payments that equal the required debt service on the bonds. Additional amounts may also be due per the terms of the lease agreement. The lease agreements provide the state with options to purchase the building during the term of the lease and transfer ownership of the building to the state at the end of the lease. The office building is scheduled for occupancy in September 2005.